Supreme Court, U. S.
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Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals For the Sixth Circuit

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PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals For the Sixth Circuit

The Petitioner, Ike Slodov (Slodov), respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on April 5, 1977, insofar as it holds the Petitioner responsible for unpaid trust fund taxes for that period before he assumed command of the corporate taxpayer.

OPINIONS BELOW

The opinion of the Court of Appeals, not yet reported as of the date of preparation of this Petition, appears in the Appendix hereto. The opinions of the District Court are found at 74-2 U.S.T.C. Par. 9719 (N.D. Ohio, 1974);

and 75-2 U.S.T.C. Par. 9829 (N.D. Ohio, 1975), respectively. A copy of each such opinion has been included in the Appendix for the Court's reference and convenience.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was filed on April 5, 1977, and this petition for certiorari was filed within ninety (90) days of that date. This Court's jurisdiction is invoked under 28 U.S.C.A. Sec. 1254(1).

QUESTIONS PRESENTED

1. Whether personal liability under 26 U.S.C.A. Sec. 6672 (Internal Revenue Code Section 6672) may result to a person who was not a responsible party at the time withholding and collection of trust fund taxes were effectuated, but is a responsible party at some later time when funds acquired thereafter become available to pay such taxes?

2. Whether a trust on later acquired funds arises in favor of the United States under 26 U.S.C.A. Sec. 7501 (Internal Revenue Code Section 7501), or any other legal authority for unpaid trust fund taxes for prior periods?

3. Does a responsible party violate his fiduciary duties (and thereby become personally liable) by not paying such outstanding tax liabilities when, at the time he became a responsible party, there were no funds then available to pay such outstanding trust fund taxes or any other liability?

STATUTORY PROVISIONS INVOLVED

United States Code Annotated, Title 26:

Sec. 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax.

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. Aug. 16, 1954, c. 736, 68A Stat. 828."

Sec. 7501. Liability for taxes withheld or collected.

> "(a) General rule.—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with

> respect to the taxes from which such fund arose.
>
> "(b) Penalties.—For penalties applicable to violations of this section, see sections 6672 and 7202."

STATEMENT OF THE CASE

Slodov purchased all of the shares of Tas-Tee Corporation (the "Corporation") on January 31, 1969, and on the same day assumed control and command of the Corporation. During purchase negotiations, the sellers represented to Slodov that there were sufficient moneys in the treasury to pay all taxes and existing obligations to creditors. At the time Slodov assumed control there were unpaid trust fund taxes owing to the United States for various quarters ending in 1968 totaling about $177,000.00. In fact, however, when Slodov took charge of the Corporation, **there were then no funds available to pay any of the unpaid taxes or other debts.** Such taxes have not been paid.

Operating funds generated by the business of the Corporation after January 31, 1969, were used to pay current taxes and other operating expenses. On or about June 4, 1969, Slodov withdrew from the Corporation's direction. Thereafter, Slodov entered into a proceeding for a Real Property Arrangement under Chapter XII of the Bankruptcy Act.

In the course of the Bankruptcy proceeding, Internal Revenue Service filed various claims against Petitioner as a responsible officer of the Corporation for unpaid trust fund taxes for the period prior to January 31, 1969.

The Bankruptcy Judge who heard this controversy held that Slodov was not a responsible officer of the Corporation prior to January 31, 1969, since he was not responsible for the withholding, accounting for **and** payment of such taxes. He could, therefore, not be held liable under Internal Revenue Code Section 6672 for unpaid trust fund taxes arising prior to that date. On appeal, the District Court upheld the Bankruptcy Judge's finding that Slodov was not a responsible person for unpaid taxes arising prior to January 31, 1969. The Court of Appeals for the Sixth Circuit, in turn, reversed the District Court's decision. It held that Slodov was a responsible officer against whom a penalty could be assessed for unpaid taxes arising prior to January 31, 1969. The Court of Appeals remanded the case to the District Court for a determination of the exact amount of liability arising as a result of its decision.

REASONS FOR GRANTING THE WRIT

1. The Decision Below Conflicts With the Decision of the Court of Appeals for the Fifth Circuit As to the Proper Interpretation of 26 U.S.C.A. Secs. 6672 and 7501.

Section 6672 of Title 26 provides, in substance, that "Any person required to collect, truthfully account for, and pay over any tax . . ." shall be subject to a penalty equal to such tax if he ". . . willfully fails to collect such tax, or truthfully account for and pay over such tax. . .".

The Sixth Circuit has here read the imposing language of Section 6672 in the **disjunctive** rather than in the

conjunctive as the statute is written. In this regard, the Court said with regard to Slodov:

> "It is immaterial that he was not in control of the corporation at the time it paid wages from which the income and social security taxes were deducted. He did not 'truthfully account for and pay over such tax' and this rendered him personally liable for the amount of the taxes."

The Fifth Circuit, in the case of *McCullough v. U. S.*, 462 F.2d 588 (1972), interpreted the language of Section 6672 differently. The Fifth Circuit said:

> "The government here contends for a position which would, in effect, change the language of Section 6672 from 'person required to collect, truthfully account for, and pay over' to 'person required to collect, truthfully account for, *or* pay over.' The government thus seeks to fix liability on R. F. McCullough because he was president of the corporation during a time when sufficient funds came into the corporation's coffers which, in cumulative amount at least, would have been sufficient to discharge the corporation's liability for unpaid taxes. The principal difficulty with this argument is that this is not the way the statute is written and there is no statutory authorization for collection of this penalty, even though the taxpayer had free funds available for the purpose of paying the taxes."

A direct conflict between the Circuits was created respecting the correct interpretation of Section 6672, when the Sixth Circuit specifically rejected the Fifth Circuit's interpretation of Section 6672:

> " . . . we do not agree with those decisions which have indicated that personal liability under Section 6672 may only be incurred by persons who are responsible parties at the time withholding or collection is required to be effected as well as when reports and payments are required to be made. See *McCullough v. United States, supra,* 462 F.2d at 590."

Further, the principles of the *McCullough* case decision are in conflict with the case decision below. In the *McCullough* case, the government argued that notwithstanding Section 6672, Internal Revenue Code Section 7501 imposed a trust upon funds coming into the coffers of the corporation and that it became the duty of any person who later had access to such funds to apply them for purposes for which the trust was impliedly created. The Court did not answer that argument because it did not find that the petitioner in *McCullough* received funds from which payment of the taxes could be made. The Court said:

> ". . . We do not decide the liability of a person who becomes an officer responsible for the payment of withheld but not accounted for and not paid withholding and F.I.C.A. taxes at a time when the corporation has funds from which the managing head of the corporation could discharge the defaulting corporation's trust obligation to the government and exercises his control to disburse such trust funds for other purposes."

Notwithstanding the above quotation, the Court, in *McCullough,* earlier stated that there is "no statutory authorization for the collection of this penalty, even though the taxpayer had free funds available for the purpose of paying the taxes." The Sixth Circuit Court in the decision below did not believe that the *McCullough* case decision or reasoning was dispositive of the issue. It, therefore, held that since Slodov received funds generated after the time he took charge of the corporation and used such funds to pay creditors, he violated his fiduciary responsibilities for unpaid trust fund taxes arising prior to the time he took command of the Corporation. The principles of the circuits conflict. The Sixth Circuit holds that a trust is impressed on after-acquired funds. The reasoning of the Fifth Circuit, however, would appear to bar creation of a trust for the benefit of the government on **after-acquired** funds, although it did not rule on the trust theory as to funds on hand **at the time** the officer becomes a "responsible" officer.

2. The Decision Below Raises Significant and Recurring Problems Concerning Accountability of a Responsible Person for Trust Fund Taxes.

The Sixth Circuit's opinion in this case reflects important statutory and policy considerations respecting the collection of trust fund taxes. This Court has not had the opportunity to address itself to the proper interpretation of Internal Revenue Code Sections 6672 and 7501 with respect to the liabilities imposed thereunder. Among the unanswered questions thus raised are:

1. Are the imposing requisites of Internal Revenue Code Section 6672 to be read in the **conjunctive** rather than in the **disjunctive**? The Fifth Circuit has said that the imposing language is to be read in the conjunctive, whereas the Sixth Circuit has said the opposite.

2. Is there any basis in law for the creation of a trust in favor of the government on after-acquired funds, unrelated to the withholding of any taxes and after the actual withheld funds have been used for other purposes?

3. If, under the so-called "trust fund" theory, a trust in favor of the government arises on after-acquired funds, does a person assuming a fiduciary capacity at a time when there are no available funds, subject himself to personal liability under Section 6672 or under Section 7501 when he pays other creditors from such after-acquired funds?

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Sixth Circuit.

Respectfully submitted,

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Dated: June 22, 1977

APPENDIX

OPINION AND JUDGEMENT OF THE COURT OF APPEALS

(Filed April 5, 1977)

No. 75-2496
No. 75-2497

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

IN THE MATTER OF SLODOV, DEBTOR IKE SLODOV,
Appellant and Cross-Appellee,

v.

UNITED STATES OF AMERICA on behalf of the
INTERNAL REVENUE SERVICE,
Appellee and Cross-Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF OHIO, EASTERN DIVISION.
Decided and Filed April 5, 1977.

Before: EDWARDS, CELEBREZZE and LIVELY, Circuit Judges.

LIVELY, Circuit Judge. These consolidated appeals concern the personal liability of a controlling officer of a corporation for income taxes and social security taxes withheld from the wages of employees but never paid over to the government. The controlling officer is now the debtor in proceedings for a real property arrangement under Chapter XII of the Bankruptcy Act. The following statement of the case appears in the opinion of the Bankruptcy Judge, 74-2 USTC ¶ 9719, adopted by the district court in its memorandum opinion, 75-2 USTC ¶ 9829, following a petition for review:

> Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.
>
> During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient money in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately. Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.
>
> . . .
>
> The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:
>
> > "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828)."
>
> Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970.

The claim of the United States related to two distinct periods, one covering income taxes and social security taxes withheld from wages of employees ("trust fund taxes") prior to January 31, 1969 and the other being concerned with such taxes withheld after Dr. Slodov took control of Tas-Tee Catering on that date. Claim No. 29 encompassed both time periods, and the Bankruptcy Judge sustained Slodov's objections to that claim in its entirety. Upon review, the district court affirmed the order of the Bankruptcy Judge with respect to that portion of Claim No. 29 which related to taxes withheld by Tas-Tee Catering prior to the time that Slodov took control, but reversed the order with respect to taxes withheld after control passed to him. Both parties have appealed.

SLODOV'S APPEAL

The taxpayer asserts that the district court erred in holding that he is liable for trust fund taxes of Tas-Tee Catering for the period from February 1, 1969 to July 15, 1969. This claim of error has two bases—first, that it is clear from the evidence that Slodov caused the corporation to collect, truthfully account for and pay over all trust fund taxes due to the United States for the period after January 31, 1969 during which he controlled the affairs of the corporation; and second, that there was an agreement between the Internal Revenue Service and the corporation by which payments during this period were to be applied to the current liability of the corporation for income taxes and social security taxes withheld from the wages of employees. The taxpayer testified at length concerning an agreement for the application of payments, and his testimony was supported by that of two former Tas-Tee Catering employees who were called by the government. The IRS agent in charge of the case testified that no such agreement existed and that if it did exist, IRS was not bound by it. He applied some of the payments to other tax liabilities of the corporation, including the employer's share of social security taxes.

The Bankruptcy Judge found that the total payments from Tas-Tee Catering to IRS during the period February 1, 1969-July 15, 1969 were virtually identical with the total liability of the corporation for trust fund taxes during that period and that, except for the decision of an IRS agent to apply these payments to the corporate share of social security taxes, ". . . there would have been no withholding tax deficiencies subsequent to February 1, 1969." The Bankruptcy Judge also found that the payments made by Tas-Tee Catering to IRS during this period were made pursuant to ". . . an understanding, agreement, and request to Internal Revenue Service for application of the withholding taxes to current withholding liabilities." Even though the IRS agent testified that he was not bound by an agreement for the application of payments by a taxpayer, it is undisputed that several of the payments were applied in accordance with the agreement at a time when the corporation had extensive liability for its own share of current social security taxes as well as withholding tax liability for previous periods. The Bankruptcy Judge concluded from these findings that the trust fund taxes which accrued during the period of Dr. Slodov's control of Tas-Tee Catering were paid in full and that payment of other corporate debts during this period was not evidence of willful failure to pay withholding taxes since there had been no showing that corporate funds were intentionally used to prefer other creditors over the United States.

In reviewing the decision of the Bankruptcy Judge the district court did not refer to the finding that all trust fund liability of the corporation during the period of Dr. Slodov's control had been paid in full. With respect to an agreement between IRS and the corporation, the district court held that if such an agreement did exist it would not affect Dr. Slodov's individual liability under Section 6672. The main thrust of the district court's holding was to the effect that the Bankruptcy Judge applied an incorrect legal standard in determining whether or not Dr. Slodov's conduct in paying other debts of the corporation was willful within the meaning of Section 6672. Though the government contended otherwise in the district court, it now concedes that a designation by a taxpayer as to how a voluntary payment of taxes is to be applied is binding on the Internal Revenue Service. It continues to argue, however, that there is no evidence of an agreement between Tas-Tee Catering and IRS as to the application of payments and no evidence that a request was ever conveyed to personnel of IRS that the amounts paid should be applied first to the current trust fund liabilities of the corporation. It maintains that the findings of the Bankruptcy Judge are clearly erroneous.

If the district court had considered the findings of the Bankruptcy Judge, review would have been subject to Rule 810, Federal Rules of Bankruptcy, which provides:

> Rule 810. Disposition of Appeal; Weight Accorded Referee's Findings
>
> Upon an appeal the district court may affirm, modify, or reverse a referee's judgment or order, or remand with instructions for further proceedings. The court shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge of the credibility of the witnesses.

In *McDowell v. John Deere Industrial Equipment Co.*, 461 F.2d 48, 50 (6th Cir. 1972), we held that it is firmly established in this circuit that findings of fact of a Referee in Bankruptcy (now Bankruptcy Judge) should not be disturbed by a district judge unless there is "most cogent evidence of mistake or miscarriage of justice." A review of the evidence heard and received by the Bankruptcy Judge discloses ample support for his findings both with respect to the existence of an agreement for the application of the payments in question to current trust fund liabilities and that designations accompanied specific payments.

If the Internal Revenue Service had honored the agreement and designations found to exist by the Bankruptcy Judge, the corporation's liability for income taxes and social security taxes withheld from the wages of its employees during the period from February 1, 1969 to July 15, 1969 would have been satisfied. Since the payments by Tas-Tee Catering during the period of Dr. Slodov's control were virtually identical with the corporation's liability for trust fund taxes withheld during that period and these payments were made pursuant to an agreement that they be applied to current trust fund liability, Section 6672 of the Internal Revenue Code never came into play. The purpose of Section 6672 is to provide an additional remedy for the government in the form of a "penalty" tax against individuals responsible for the failure of a corporation to satisfy its tax liabilities. An individual who has caused the corporate obligations for trust fund taxes to be paid may not be held personally liable under Section 6672 because the IRS chooses to ignore a binding agreement and credits these payments to other corporate tax liabilities. *McKenzie v. United States*, 536 F.2d 726 (7th Cir. 1976).

THE CROSS-APPEAL

The district court affirmed the holding of the Bankruptcy Judge that Dr. Slodov is not liable under Section 6672 for income taxes and social security taxes required to be withheld by Tas-Tee Catering from the wages of its employees prior to January 31, 1969. The Bankruptcy Judge found from the testimony and exhibits that as of the date on which Dr. Slodov took control the corporation had no liquid assets and there were no escrow accounts or tax depository accounts. The Bankruptcy Judge held that Slodov was not a "responsible officer" prior to January 31, 1969 and that on that date no trust funds came into his control. In affirming the holding that Dr. Slodov was not liable under Section 6672 the district court stated:

> The debtor had no role in the corporations until January 31, 1969. He had no control over financial decisions. He had no opportunity to collect or direct collection of the taxes as they accrued. And therefore, under the clear and unequivocal language of § 6672, he is not a "person required to collect, truthfully account, [sic] for any pay over any tax . . . ."

The district court cited *McCullough v. United States*, 462 F.2d 588 (5th Cir. 1972), in which the court held that a person who had no responsibility for the collection of or accounting for taxes withheld during a particular period but who later controlled the corporation could not be held personally liable under Section 6672 for failure to pay the taxes to the government. However, we do not find *McCullough* to be dispositive of the issue on cross-appeal. The *McCullough* court found that the taxpayer never had available unencumbered funds with which to pay taxes that had previously been withheld and not paid over to the government. The court stated that it therefore did not "decide the liability of a person who becomes an officer responsible for the payment of withheld but not accounted for and not paid withholding and FICA taxes at a time when the corporation has funds from which the managing head of the corporation could discharge the defaulting corporation's trust obligation to the government and exercises his control to disburse such funds for other purposes." *Id.* at 590. The evidence is undisputed that Tas-Tee Catering had in its possession during the period of Dr. Slodov's control large sums of money which it used to pay debts and operating expenses. Therefore we must decide the question not reached by the Fifth Circuit in *McCullough.*

There is no doubt in the present case that Dr. Slodov knew that withheld taxes for periods prior to his taking control were unpaid. He attempted to pay these taxes with a corporate check immediately after assuming responsibility for the affairs of Tas-Tee Catering and later stopped payment on the check when he discovered that there were no funds at that time to make the check good or to pay other obligations of the corporation. In seeking affirmance of the district court on this issue the debtor argues that if funds representing taxes previously withheld by the corporation never came into his hands as a subsequent responsible party and no funds were available at the time he became the person in control of the corporate affairs, he may not be held liable under Section 6672. The government contends that there is no distinction between the position of a taxpayer who takes control of a corporation which has withheld taxes in its possession and dissipates them for other purposes and one who takes over such a corporation with no funds and uses money subsequently acquired by the corporation to pay other obligations to the detriment of the government.

An employee's income tax account and social security account are credited with the amounts reported by the employer as withheld for these purposes whether the employer pays them over to the government or not. The taxes required to be collected or withheld are intended by Congress to be treated as special funds held in trust for the United States. 26 U.S.C. § 7501; *Harrington v. United States,* 504 F.2d 1306 (1st Cir. 1974); *Spivak v. United States,* 370 F.2d 612, 615 (2d Cir.), *cert. denied,* 387 U.S. 908 (1967). The "willfulness" required for personal liability under Section 6672 exists if those with power and responsibility within the corporate structure for seeing that taxes which have been withheld are remitted to the government, acting voluntarily, consciously and intentionally, use corporate funds to pay other obligations rather than using them to pay withheld taxes. *Harrington v. United States, supra,* 504 F.2d at 1311; *Monday v. United States,* 421 F.2d 1210 (7th Cir.), *cert. denied,* 400 U.S. 821 (1970).

The Ninth Circuit dealt with a case similar in many respects to the present one in *Teel v. United States,* 529 F.2d 903 (1976). There responsible officers were found to have known that there were arrearages in payments of income and social security taxes in previous quarters, but they continued the operation of the business, using funds generated from the sales of inventory and manufactured products to pay for new merchandise. The court held that they acted willfully in failing to pay the taxes, stating ". . . as the cash went into the cash drawer, it became subject to trust or lien in favor of the federal government for the unpaid withholding taxes. By dissipating the cash for new purchases, of which the taxpayers knew, they unwittingly supplied the necessary willfulness." *Id.* at 905. *Teel* differs from the present case in that the taxpayers were responsible officers both during the time when withholding was required and when payment was due. However, we do not agree with those decisions which have indicated that personal liability under Section 6672 may only be incurred by persons who are responsible parties at the time withholding or collection is required to be effected as well as when reports and payments are required to be made. *See McCullough v. United States, supra,* 462 F.2d at 590.

We conclude that it is irrelevant whether there were unencumbered funds on hand at the time Dr. Slodov took control of Tas-Tee Catering. Prior to that time the employees of the corporation had received net wages which reflected withholding for income taxes and social security taxes. Whether these withheld taxes were segregated and held in special accounts or not they became trust funds for the payment of the withholding obligations of the corporation to the United States. When the corporation came into possession of funds after Dr. Slodov acquired control, these funds were impressed with a trust to the extent of the corporation's obligations for previously unpaid withholding income taxes and employees' share of social security taxes. Though created before Dr. Slodov's control of the corporation began, these obligations continued after that date, and he was clearly the person responsible for paying them when funds became available. In a different context this court has considered the meaning of the word "person" as it is defined in 26 U.S.C. § 6671(b) and referred to in § 6672. In *Mueller v. Nixon,* 470 F.2d 1348 (6th Cir. 1972), *cert. denied,* 412 U.S. 949 (1973), we decided to adopt a "broad interpretation" of the word "person" in order to give the full meaning to the intention of Congress. In the *Mueller* opinion the court quoted Section 6672 and then stated:

> As we read this section, it is squarely addressed to the person or entity responsible for the payment of the withheld taxes. It is knowledge of the tax delinquency and authority over the decision to pay or not to pay the taxes which is at issue—not who has the duty of filling out the forms. *Id.* at 1350.

Dr. Slodov clearly knew that Tas-Tee Catering had not paid income taxes and social security taxes withheld from the wages of its employees prior to the date that he took control of the corporate affairs, and when he caused subsequently acquired funds to be used for satisfaction of other corporate debts and payment of operating expenses instead of paying these preexisting obligations he exposed himself to personal liability under Section 6672. As the court stated in *Braden v. United States*, 442 F.2d 342, 344 (6th Cir.), *cert. denied sub nom. Bonistell v. Braden*, 404 U.S. 912 (1971)—

> If the appellant was aware of the fact that the taxes were unpaid, and, possessing the power and responsibility to pay them, failed to do so, then he is liable for the penalty of section 6672 notwithstanding his lack of malice or wrongful purpose. (Citations omitted).

It is immaterial that he was not in control of the corporation at the time it paid the wages from which the income and social security taxes were deducted. He did not "truthfully account for and pay over such tax" and this rendered him personally liable for the amount of the taxes.

The judgment of the district court is reversed on the appeal and cross-appeal, and the cause is remanded for further proceedings.

MEMORANDUM, OPINION AND ORDER OF THE DISTRICT COURT

(Filed September 8, 1975)

No. B 70-4787

UNITED STATES DISTRICT COURT
Northern District of Ohio
Eastern Division

IN THE MATTER OF:
IKE SLODOV,
Debtor

MEMORANDUM OPINION AND ORDER

Lambros, *District Judge*

This matter is presented for review of a decision denying the claims of the United States relating to a bankrupt debtor's withholding and F.I.C.A. taxes, the obligations arising from his orthodontia practice and from sums due under 26 U.S.C. §6672, the penalty provision[1] allowing assessment of taxes against an officer of a corporation.

The questions presented for review are these:

1. Was the debtor liable for withholding and F.I.C.A. taxes for the fourth quarter of 1969, in the amount of $445.69?

2. Was the debtor responsible for payment of federal withholding (trust fund) taxes for the second quarter of 1968 and the fourth quarter of 1968, as

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[1] The provision is not a penalty *per se* but rather an alternative tax collection device.

owed otherwise by Tas-Tee Catering, Inc., and related companies, and was his failure to pay willful?

3. Was the failure of the debtor to collect and to pay over federal withholding (trust fund) taxes owed by Tas-Tee Catering, Inc., and related companies during the period from February 1, 1969, through July 15, 1969, a *willful* failure?

4. Was there any agreement or understanding between the Internal Revenue Service and the debtor to the effect that moneys paid to the Internal Revenue Service would first be applied to the withholding portions of federal employment taxes, and if so, is that agreement enforceable in this proceeding?

I. QUESTION 1 FOR REVIEW

This claim is factually distinct from those raised in the other questions presented. The claimant seeks to recover $445.69 due as withholding and F.I.C.A. taxes for the fourth quarter of 1969, the obligation having its origin in the debtor's dental practice. The Government contends that the Bankruptcy Judge incorrectly placed the burden of proof upon the United States as a claimant and that the evidence presented was insufficient to sustain the findings made by the Bankruptcy Judge.

The Court finds that the burden of proof is properly placed on the Government when it seeks to collect a tax. The assessment of taxes is sufficient to establish a prima facie case forcing the debtor to go forward with evidence to rebut, but the United States as a claimant seeking to collect taxes has the burden of proof. *Bar L. Ranch v. Phinney*, 426 F.2d 995 (5th Cir. 1970); 3A *Colliers on Bankruptcy* §64.409. This was the standard applied by the Bankruptcy Judge and upon review of the evidence this Court cannot hold that the decision of that Judge based on the evidence presented to him was improper. *In re Mascolo*, 505 F.2d 274 (1st Cir. 1974).

The Bankruptcy Judge's decision on this issue is affirmed.

II. QUESTIONS 2, 3 AND 4 FOR REVIEW

The other three issues presented for review herein arise from the same factual background which in relevant part is as follows:

> Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.
>
> During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient money in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that

there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately. Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.

. . .

The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:

> 'Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828).'

Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970. *Opinion, Date July 1, 1974, Pages 1 and 2.*

A. *Question 2*

The Government contends that the Bankruptcy Judge applied the wrong standard in determining whether or not the debtor's conduct was "willful" within the meaning of §6672. The Government is correct that the decision as to "willfulness" is not dependent on whether the responsible corporate official acted in bad faith or with improper motives. The test for "willfulness" in regard to §6672 is only whether or not the corporate official decided voluntarily not to pay the taxes owing. *Dudley v. United States,* 428 F.2d 1196 (5th Cir. 1970); *Bloom v. United States,* 272 F.2d 215 (9th Cir. 1959), *cert. den.,* 363 U.S. 803. To the extent the Bankruptcy Judge applied another standard, his decision is reversed.

However, the Court finds that there is a more important issue which appears in the facts presented and which facts are not disputed by the parties. The debtor had no role in the corporations until January 31, 1969. He had no control over financial decisions. He had no opportunity to collect or direct collection of the taxes as they accrued. And therefore, under the clear and unequivocal language of §6672, he is not a "person required to collect, truthfully account for and pay over any tax. . . ." As the Court of Appeals for the Fifth Circuit observed in *McCullough v. United States,* 462 F.2d 588 (1973):

> The government here contends for a position which would, in effect, change the language of Section 6672 from 'person required to collect, truthfully account

for, and pay over' to 'person required to collect, truthfully account for, or pay over.' The government thus seeks to fix liability on R.F. McCullough because he was president of the corporation during a time when sufficient funds came into the corporation's coffers, which, in cumulative amount at least would have been sufficient to discharge the corporation's liability for the unpaid taxes. The principal difficulty with this argument is that this is not the way the statute is written and there is no statutory authorization for the collection of this penalty, even though the taxpayer had free funds available for the purpose of paying the taxes. *McCullough, supra,* at 590.

Accordingly, the Court affirms the finding of the Bankruptcy Judge that the debtor is not liable under §6672 for the taxes arising during the 2nd and 4th Quarters of 1968, or during January 1969.

B. *Question 3*

The Government also seeks review of the Bankruptcy Judge's findings that the debtor did not act willfully in failing to pay the taxes due from February 1, 1969 through July 15, 1969. The Court, as noted in the preceding section, finds that the proper test for "willfulness" is whether or not the debtor voluntarily chose to pay creditors other than the United States. *Monday v. United States,* 421 F.2d 1210 (7th Cir. 1970), *cert. den.* 400 U.S. 821; *Werner v. United States,* 374 F.Supp. 558 (D.Conn. 1974); and *Stake v. United States,* 347 F.Supp. 823 (D.Minn. 1972).

From the evidence presented, the Court finds that the debtor did voluntarily elect to pay other creditors instead of the United States and for that reason, his conduct constituted a "willful" violation of the obligations imposed upon him.

The determination made by the Judge that the debtor's conduct was not "willful" as that term is used in §6672 is therefore reversed.

C. *Question 4*

The Government's final question for review is whether the Bankruptcy Judge's findings that there was in existence an agreement between the Internal Revenue Service and the debtor as to how the payments were to be applied were proper.

The taxes in question are employment taxes, which have both an employee and an employer share. The reach of §6672 is only to the employee's share, for it is only that portion the employer is obligated to collect and pay over, standing in a trustee-like relationship to the employee and to the Government.

Assuming that finding was an agreement as to the designation of the payments during 1969, this designation involved only the corporation, not its officers. The personal liability of the officers is in no way dependent on agreements with the employer corporation. *Monday, supra*; *cf., Spivak v. United States,* 370 F.2d 612 (2nd Cir. 1967), *cert. den.,* 387 U.S. 908.

To hold otherwise would allow the officers of a corporation to convert those trust funds to business purposes and still avoid any personal liability. The intent of Congress to impose responsibility on corporate officers in charge of employment taxes is clear, and may not be frustrated by agreements involving the corporate employer.

The decision of the Bankruptcy Judge as to this issue is accordingly reversed.

III. CONCLUSION

The Opinion of the Bankruptcy Judge, entered July 1, 1974, is affirmed in part and reversed in part. The Court remands the case for further proceedings, to include recomputation of the debtor's obligation for 1969, the Court having found him not personally liable for the employment tax obligation arising in January 1969. The Court would further note that the claimant's contention that only $233,056.31 was paid on the 1969 obligations appears correct, the other $10,795.76 having properly been applied to 1968 corporate obligations. Thus further recomputation will be required to determine the exact sum owed to the claimant.

IT IS SO ORDERED.

/s/ Thomas D. Lambros
United States District Judge

JUDGMENT OF THE DISTRICT COURT

(Filed September 9, 1974)

No. B 70-4787

UNITED STATES DISTRICT COURT
Northern District of Ohio
Eastern Division

IN THE MATTER OF
IKE SLODOV,
Debtor

JUDGMENT

Lambros, *District Judge*

In accordance with the decision in the Memorandum Opinion and Order entered this date, this case is remanded to the Bankruptcy Court for further proceedings.

IT IS SO ORDERED.

/s/ Thomas D. Lambros
United States District Judge

OPINION OF THE DISTRICT COURT

(Filed July 1, 1974)

Case No. B70-4787

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF:
IKE SLODOV,
Debtor

In Proceedings for a Real Property Arrangement under Chapter XII

OPINION

STATEMENT OF FACTS

(Filed July 1, 1974)

Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee Vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.

During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient monies in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately. Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.

There was a provision in the agreement of sale whereby Ike Slodov agreed to hold harmless the four sellers from payment of certain tax liabilities of Tas-Tee Catering. The following is the provision of the agreement of sale:

> "Buyer shall hold Sellers harmless from and against all loss, liability, damage or expense arising out of any claims, demands, penalties, fines, taxes or other loss resulting directly or indirectly from the assertion against Russell's Foods, Inc. of claims by the Federal Government, State Government, County Government or City Government for taxes and assessments. Buyer expressly acknowledges their understanding that there is an obligation of Russell's Foods, Inc. to pay taxes in the approximate amount of $250,000.00 on or before January 31, 1969."

Debtor Ike Slodov introduced at the hearing of this issue Exhibit 7, wherein the same four selling shareholders dismissed all claims against the debtor relating to such stock purchase agreement.

The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828)."

Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970.

The Issues

A) Is the claim of Internal Revenue Service based on the theory of third party beneficiary under the "hold harmless" paragraph of the agreement, wherein the debtor Ike Slodov agreed to hold four sellers harmless from payment of certain taxes of Tas-Tee Catering, a valid claim?

B) Were the acts of the debtor Ike Slodov intentional and willful under Section 6672 of the Internal Revenue Code?

Discussion of the Issues

> "As in the case of other types of claims, a filed proof of a tax claim in proper form establishes a prima facie case for the allowance of the claim. The burden of proof is on the claimant, but the burden of going forward and introducing evidence to rebut the prima facie case is on the objecting party..."

3A Colliers on Bankruptcy, §64.409.

The objecting debtor carried his burden of going forward to rebut the prima facie case as to each of the two claims.

Claim No. 80 in the amount of $229,511.58 is filed as an unsecured claim based on the theory of third party beneficiary under the agreement for sale of the Tas-Tee Catering stock wherein Ike Slodov agreed to hold four individual sellers harmless from payment of certain tax liabilities of Tas-Tee Catering and related companies.

The debtor Ike Slodov introduced Exhibit 7, wherein those same selling shareholders dismissed all claims against the debtor related to such stock purchase agreement. It should be noted that such persons acknowledged in Exhibit 7 that the so-called stock purchase agreement "shall be considered null and void."

It is well settled that "in order that a third person may enforce a promise made for his benefit, it must appear that the contract was made and entered into directly or primarily for the benefit of such third person." (11 *O. Jur 2d, 426, Contracts* §177; also see 17 *Am Jur 2d, 727,* *Contracts* §304, entitled "Necessity of, and what constitutes, intent or purpose to benefit third person.")

The debtor Ike Slodov testified that when the agreement was signed, he had no intent to benefit the Internal Revenue Service and that the agreement was solely for the intended benefit of sellers and debtor personally.

Claimant offered no testimony or evidence whatsoever to carry its burden of proving the following:

1) That there is in existence a valid enforceable contract;
2) That provided there was a valid contract, there was intent to "directly or primarily" benefit claimant;
3) That it had valid claims against the sellers and had collected or had the ability to collect from such sellers, thereby invoking the hold harmless provision—again provided it were part of a valid agreement.

The evidence disclosed that the debtor took command of the company on January 31, 1969, and that there were numerous conferences in which the debtor emphasized that money should be set aside for the payment of taxes. Within five weeks thereafter, the debtor had deposited $42,000 in the Lake County National Bank for the purpose of paying Internal Revenue Service. At that time he called Internal Revenue Service stating that the $42,000 was in the Lake County National Bank for the purposes of paying the taxes. The next day Internal Revenue Service attached the $42,000. The debtor had charge of the company for less than six months, and at those periods he or his accountant had numerous conferences with Internal Revenue Service attempting to solve the problem of taxes.

A. *Claim No. 29—Withholding and FICA (personal) taxes in the amount of $445.69*

Debtor rebutted this personal claim by his testimony that he had never been notified of a deficiency claim on his withholding; that he had always paid his employees' withholding when due; that Internal Revenue Service had audited his withholding and personal tax returns through the claimed 4th quarter of 1969 and had determined a refund of $6,674.84 due him; that such refund had actually been held by Internal Revenue Service for application to one of the Tas-Tee accounts.

Debtor's independent accountant testified she had participated with an Internal Revenue Service agent in such audits and that no finding or claim had ever been made for such withholding and that as late as November 19, 1973, the date of the latest correspondence from Internal Revenue Service (debtor's exhibit 9), no claim had been made for such tax.

The United States failed to give any direct testimony or explanation of such tax claim and wholly failed to carry its burden of proof on such portion of claim no. 29.

B. *Claim No. 29 as supplemented—100% penalty (Section 6672), Charles Corporation, Tas-Tee Catering and Tas-Tee Vending withholding tax and withheld FICA*

In Section 6672, Congress has provided the Internal Revenue Service with an extraordinary collection tool. A responsible officer can be held *personally* liable for payment of a corporate debt. Congress has declared that an employer must withhold federal income tax and social security from payrolls. Such withheld funds become *trust* monies for which the employer is merely a custodian until paid. The claimed failure by debtor to pay such trust funds (withholdings) must have been *willful*. Congress in its wisdom granted a responsible officer such protection.

The Courts have long recognized the requirement of proof of willfulness in Section 6672 cases. One of the outstanding cases is *Ferguson, et al. v. Warren*, 63-2 USTC ¶9783 (W. Dist. Wash., 1963). This case involved a suit for refund of taxes paid under a 6672 assessment. The jury returned a verdict in favor of the taxpayer-plaintiffs and found that they did not willfully fail to pay the Government income and social security taxes withheld by a corporation. In its charge, the Court stated:

> ". . . The responsible person must have known the taxes were due and consciously and deliberately disregarded payment of them, having funds within his control with which to do so. . ."

When and how were the claimed withholding tax liabilities incurred? The claim (adding the three companies together) shows the following:

$313,740—Total claim

$26,974 is reported as due on *2nd quarter 1968*.

Debtor took control on January 31, 1969. The exhibits and testimony showed, as of that date, there were *no liquid assets—no escrow accounts or tax depository accounts*. In fact, there was *no evidence* by the claimant that the $26,974 had been withheld. Obviously, if the funds had been withheld, they had been used long before by prior management.

$150,362 is reported as due on *4th quarter 1968*.

Debtor's management was not in the companies in those months. Again, *all the evidence* demonstrates that by the time debtor took control, any withheld tax funds or any other liquid assets were long gone.

$?—January, 1969.

Internal Revenue Service has not provided a breakdown on this period of time during which the companies failed to deposit or otherwise hold the withheld taxes for payment. Again, *debtor had no responsibility under Section 6672 during January to withhold and had no control of such monies*—none were on hand on January 31, 1969.

Is the debtor liable for the above withholdings under some theory other than as a "responsible" officer during those periods?

Section 6672 is the basis of this claim and is silent as to any basis other than responsible person who willfully fails to pay over such funds. Again, *DEBTOR WAS NOT A RESPONSIBLE OFFICER PRIOR TO JANUARY 31, 1969, AND AT THAT DATE CONTROLLED NO SUCH TRUST FUNDS.*

Did debtor assume some contractual liability with Internal Revenue Service by signing the 4th quarter 941 return and by signing company checks on overdrawn accounts? The 941 form, the checks, and the total evidence presented by claimant supports no such assumption of contractual liability and no such contractual liability set forth in this claim nor in Section 6672.

Computed from the claim on file, *at least* $177,336 of this claim *IS ON WITHHOLDINGS DURING 1968.*

That leaves approximately $137,000 for all of 1969, and some undetermined amount of the $137,000 represented January, 1969, withholdings. How much of the $137,000 was ***employer's FICA*** tax covered by application of ***employees'*** withholdings?

One matter was made clear by James McLaughlin, the Internal Revenue agent—But for his application of funds paid after February 1, 1969, to corporate share of FICA, *there would have been no withholding tax deficiencies subsequent to February 1, 1969.*

Examination by debtor's counsel of Internal Revenue Service of amounts of withholding tax withheld after February 1, 1969, demonstrated such total as $253,533. This was the total *trust* money withheld as both income tax and employees' FICA, and this was the total required to be withheld under debtor's management.

Debtor's evidence and Internal Revenue Service testimony showed *$249,212 was actually paid by debtor's management.*

$253,533—withholding liability

$249,212—withheld and delivered to Internal Revenue Service

The above figures standing alone are startling, overwhelming and convincing proof that debtor established a system of withholding, segregating, and paying the withholdings and that the system was followed.

Amid times of the most extreme financial stress and chaos imaginable, debtor's team withheld the taxes, set them aside in special accounts and delivered the funds to Internal Revenue Service.

The above comparison is most impressive to demonstrate *willfulness to pay* when compared to the corporate records of total *NONwithholding* and *NONpayment* in 4th quarter 1968 and January, 1969.

Debtor's testimony together with testimony of government witnesses, Mr. Molchan and Mr. Surckla, showed that the withholding funds were delivered to Internal Revenue Service with the common understanding and agreement that these were withheld funds—trust funds—and were being delivered in that form and to cover those liabilities. The government is certainly bound by its own testimony.

As to application of these withholding monies, it is clear from all the testimony of Mr. McLaughlin and from the law that the withholding monies should be applied to withholding liability in accordance with the understanding of the officers of Tas-Tee and Internal Revenue Service. Mr. McLaughlin followed this understanding on several occasions and did apply funds to withholding liability, although there existed at that same time, extensive corporate liability for employer's FICA as well as prior withholding tax liability. He followed this understanding and agreement in several major payments of the funds segregated, levied upon and released and voluntarily paid from the Lake County National Bank depository.

The Court in *Hewitt v. United States*, 377 F. 2d 921 (1967), United States Court of Appeals Fifth Circuit held, in very broad terms, that absent any agreement, direction, or request, the Internal Revenue Service had right to apply funds of a corporation as it saw fit to federal income and social security taxes which had been withheld from employees.

It was obvious from the testimony of government witnesses (Mr. Molchan and Mr. Surckla), that there was such an understanding, agreement, and request to Internal Revenue Service for application of the withholding taxes to current withholding liabilities.

If the Internal Revenue Service chose, in its wisdom, to make an application of withholding funds to nonwithholding liabilities, it did so purely as a collection procedure. Its actions, as such, would not in any event vary or affect in any way the obvious willful intent and willful action taken by debtor and his management *to pay the withholdings liabilities.*

> "An act is willful if it is voluntary, conscious and intentional. If you find the plaintiff voluntarily, knowingly and intentionally used available funds to prefer other creditors over the United States, then you must find that he acted willfully."

(*Monday v. United States,* 421 F. 2d 1210, 72-1 USTC 9219 (E. Dist. Wisc., 1972).

The above is a statement of law given by the Court in its charge on a 6672 case.

The evidence presented by the government and by debtor showed:

1) That the debtor was in no way responsible for nonwithholding or nonpayment of withholding funds prior to February 1, 1969, as there were no such funds, or for that matter, any funds whatsoever existing upon debtor's arrival at the company;

2) After February 1, 1969, debtor's management *withheld* employees' income tax and FICA and paid such withholdings to Internal Revenue Service;

3) At no time did debtor voluntarily, knowingly, and intentionally use withholding or other available corporate funds to prefer other creditors over the United States; and

4) Debtor, by his instructions and procedures, demonstrated a *willfulness to withhold to account for* and *to pay over* the withholding taxes.

The claimant has failed in its burden to prove a willful failure to pay the withholding liabilities.

Does Section 6672 of the Internal Revenue Code impose a nonallowable "penalty" for purposes of the Bankruptcy Act? The effect of this Section is to penalize the bankrupt, or, in the instant case, the debtor; and although the Section itself provides that any responsible person who willfully fails to collect and pay over the withheld taxes is "liable to a *penalty* equal to the total amount of the tax . . . not accounted for and paid over," the actual purpose is not to penalize individuals, but to afford an alternative means of collecting a corporation's default in payment of employees' withheld taxes. The cases cited by the Government in its earlier brief of the subject, as well as its comments by way of post-trial memorandum, correctly reflect the law. Accordingly, it is not asserted that the claims should not be allowed by being designated as "100% penalty claims."

As to claim No. 80, on the basis of "third party beneficiary," for $229,511.58 for taxes due prior to February 1, 1969:

1) The contract between debtor and the four sellers is null and void and of no effect, by virtue of the dismissal with prejudice of the sellers' claims against debtor and the settlement agreement previously approved by the Court; and

2) Even if the contract was in effect, none of the selling shareholders in whose favor the "hold harmless" clause was written were ever considered liable under Section 6672 for withheld taxes by the Government, and thus, no right to recover from the debtor exists.

As to claim No. 29 for $445.69 for dental practice withholding, the testimony clearly established that this sum had been long paid and that nothing is due.

As to claim No. 29 for withheld taxes:

1) The debtor was not responsible for collection of withholding taxes until February 1, 1969. On that date there were no funds on hand for said purpose as the former owners had failed to withhold or segregate sufficient funds;

2) The debtor established a system of segregating funds for payment of withheld taxes and did, in fact, pay withheld taxes during the period February 1, 1969, to July 15, 1969;

3) *There was no willful failure* to pay over taxes as the evidence clearly indicated that the debtor, as a responsible person, and the officers of the employer-corporation *PAID THE WITHHOLDINGS* and had attempted to make it perfectly clear to the Internal Revenue Service that the payments were for current trust fund obligations. While this intention to pay was disclosed, the Government applied the funds as it saw fit contrary to said expressed intent; and

4) The mere act of signing 941 returns for periods prior to February 1, 1969, is not sufficient to render the signer liable as a responsible person under Section 6672.

CONCLUSION

The evidence disclosed that claim No. 80 in the amount of $229,511.58 is based solely on the contentions of the United States of America that it is a third party beneficiary under stock sale agreement of Russell's Foods, Inc, dated January 31, 1969.

The United States relied entirely on its claim as filed offering no additional evidence thereon.

Debtor produced evidence of agreement by all parties to such stock purchase contract that such stock purchase contract had been deemed null and void and of no effect and that the suit filed by the parties to the contract had been dismissed with prejudice. Debtor further testified that he and the parties signatory to the contract had no intent to benefit the United States of America. The United States offered no evidence or testimony contrary to debtor's evidence.

The contract wording further reflects no intent to benefit the United States of America. The United States further offered no evidence of payment of taxes by any of the parties to the stock contract and no evidence that any of such parties were responsible persons required to pay withholding taxes. Accordingly, there was, in any event, no showing of liability of debtor through operation of the purported indemnification clause.

The Court, therefore, sustains the debtor's objections as to claim No. 80.

Coming now to claim No. 29 as amended October 15, 1973, the Court notes that such claim is in the total amount of $313,740.79, of which sum $445.69 is attributable to Ike Slodov, employer No. 34-0909176, and claimed as a nonpayment of withholding and FICA for 4th quarter 1969.

The United States of America, claimant, relied entirely on its claim as filed together with claimant's Exhibit 1 entitled "Certificate of Assessment and Payment."

Debtor testified nothing was due nor had he ever been notified nor billed concerning the claimed deficiency and that all of his personal and professional tax returns had been audited through the year 1970 and prior with a finding that there was due debtor the sum of $6,674.85, which is verified as a credit to debtor on claimant's Exhibit 1. In addition, debtor's accountant, who had personally participated in such audit, testified that all 941 withholding tax returns including 4th quarter 1969 had been reviewed and audited by an agent of the Internal Revenue Service with no finding of irregularity, no deficiency, and in fact, that there had been found due debtor from Internal Revenue Service the above-mentioned $6,674.85.

The remainder of claim No. 29 is founded upon Section 6672 of the Internal Revenue Code, which provides:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

The testimony established that debtor and his management assumed control of the Russell's Foods companies after January 31, 1969, together with its bank accounts.

As to all withholding taxes prior to January 31, 1969, debtor was not a responsible officer or person charged with withholding and paying such taxes. His act of signing 941 withholding tax returns for 4th quarter 1968 and of signing checks to pay such taxes do not, under these circumstances, render him such a responsible person.

Prior to January 31, 1969, any taxes withheld had been spent on corporate debts or otherwise as shown by the negative bank balances at the date debtor wrote the several checks to Internal Revenue Service. Accordingly, at January 31, 1969, it is clear that there were no withholding trust fund tax monies or other funds over which debtor could assume control or responsibility.

The Court finds that as to payroll withholdings on or after February 1, 1969, and continuing to around July 15, 1969, debtor was the responsible person pursuant to Section 6672.

The Court further notes, however, that Section 6672 specifies that failure to withhold or pay over such withholdings must have been *willful*.

The following are a number of circumstances and evidentiary matters which have led this Court to a conclusion that there has been no willful nonpayment of withholding taxes:

1) After February 1, 1969 (and apparently for some time prior thereto), the entire corporate and financial situation of the subject companies was in a constant and serious state of turmoil. There was a history of suits, replevins, levies, and repossession threats and signers of bank accounts which enveloped the companies at the time of debtor's assuming control. Counsel for the United States during his examination of debtor appropriately termed the company affairs as a "horror story." Debtor was, therefore, working under the worst of possible conditions for obtaining a clear understanding of financial conditions and tax liabilities.

2) This Court is impressed with the record of payment of the companies after February 1, 1969. The following are the specific payments as shown from the exhibits and record of testimony taken by the Court:

TAS-TEE CATERING, INC.

PAYMENTS

Date (1969)	Amount
Various	$54,144.15
8-11	795.76
4-11	5,000.00
2-11	4,024.67
2-14	7,968.20
2-14	3,173.11
4-11	5,000.00
4-22	4,000.00
4-21	10,000.00
4-25	15,924.00
4-29	7,728.00
5-12	21,020.08
5-26	2,256.43
5-20	8,000.00
5-26	4,070.22
6-3	8,841.55
6-4	9,000.00
6-24	7,880.32
7-2	7,080.15

TAS-TEE VENDING, INC.

PAYMENTS

Date (1969)	Amount
5-27	$5,180.00
6-3	1,261.73
6-3	1,275.48
6-24	1,428.18
7-2	765.69

CHARLES CORPORATION

PAYMENTS

Date (1969)	Amount
2-11	$ 4,348.60
2-14	4,958.44
3-18	9,558.48
4-21	5,000.00
4-25	8,926.14
4-29	2,742.03
5-12	13,029.91
5-12	3,340.91
5-26	1,673.35
6-4	5,380.00
6-3	4,049.43
6-3	4,000.00
6-24	4,054.08
7-2	3,705.94

3) The Court notes that during February and March withholding taxes were being accumulated in a special depository at Lake County National Bank and that such depository was disclosed to Internal Revenue Service agents at the earliest possible time.

4) The testimony of the two corporate officers (Mr. Surckla and Mr. Molchan) who were Government witnesses, showed direct and firm instructions voiced by debtor to pay the withholding taxes.

5) The testimony of Mr. Surckla and Mr. Molchan vividly corroborated testimony of debtor as to the enormous effort of corporate employees to pay over such withholding taxes under circumstances where Internal Revenue Service would not accept corporate checks nor delivery of cash but insisted upon certified drafts. Corporate employees expended considerable time, effort, and risk in carrying carloads of cash to various financial institutions for purposes of counting and converting cash to certified drafts.

6) The testimony further showed that neither Mr. Surckla nor Mr. Molchan had been pursued by Internal Revenue Service as responsible persons under Section 6672 for personal payment of such taxes. Therefore, the Court notes that their testimony as to instructions and efforts to pay over such taxes is clearly nonself-serving and, as a result, left the claimants with a shallow case.

7) In addition to the above payments and attempts at payment, the evidence showed debtor immediately after February 1, 1969, contacted Internal Revenue Service and advised its agents of the discovery of the dire financial circumstances and solicited assistance or guidance from Internal Revenue Service.

Claimant has contended that payment of any other corporate debts after February 1, 1969, demonstrates willfulness of debtor to avoid payment of taxes. The Court notes that the decisions cited by claimant and by debtor refer to voluntarily, knowingly, and intentionally using available funds to *prefer* other creditors over the United States. The Court further notes that the payments shown of particular large amounts by claimant were with debtor's personal funds or personal funds deposited with the corporations by debtor. It is obvious that many bills incurred in the continuing operation of the corporations were paid for day-to-day expenses, it being noted that suppliers had placed the companies on a C.O.D. supply basis. There is no evidence that any creditor was preferred nor were they paid on arrearages. It should also be noted that Internal Revenue Service knew as early as the first week in February, 1969, that the corporations were in arrears in paying withholding to a sizeable amount. Internal Revenue Service knew that the companies were continuing in their operations and that it was necessary to purchase and pay for daily merchandise and other expenses.

The weight of the evidence shows an intent by debtor to pay over withholding taxes. The evidence may show nonpayment of some withholdings in small amounts after February 1, 1969, small amounts as compared to the entirety of withholding. It is clear to the Court that any such nonpayment was not willful.

The attorney representing Internal Revenue Service, Mr. Richard F. Mitchell, made a statement in open Court that the entire transaction of the sale of Tas-Tee Catering and affiliating companies to Doctor Slodov was a "horror story."

The Court therefore sustains the objection to claim No. 29.

Attorney for the debtor will cause a Journal Entry to be prepared giving expression to this decision. Submit the same to opposing counsel before submitting it to the Court, reserving therein exceptions.

/s/ Don C. Miller
Bankruptcy Judge

JUDGMENT OF THE DISTRICT COURT

(Filed September 9, 1974)

Case No.: B70-4787

IN THE DISTRICT COURT OF THE UNITED STATES
For the Northern District of Ohio
Eastern Division

IN THE MATTER OF:
IKE SLODOV,
Debtor.

In Proceedings for a Real Property Arrangement
Under Chapter XII

JUDGMENT

At Cleveland, in said District, this 9th day of September, 1974.

This cause came on to be heard upon the Debtor's Objections to Claim Nos. 29 and 80, as filed, amended and supplemented by Internal Revenue Service, the statements of counsel, briefs of law and the evidence. The issues having been duly considered, and a decision having been duly rendered.

IT IS, ORDERED AND ADJUDGED that the Objections of the Debtor to Claim Nos. 29 and 80, as filed, amended and/or supplemented by Internal Revenue Service, be and the same are hereby sustained, and judgment is rendered in favor of the Debtor thereon.

/s/ Don C. Miller
Bankruptcy Judge

Supreme Court, U. S.
FILED
NOV 16 1977
MICHAEL RODAK, JR., CLERK

APPENDIX

Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petition for Certiorari Filed June 23, 1977
Certiorari Granted October 3, 1977

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No. B 70-4787

United States District Court

NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF

IKE SLODOV,
Debtor

RELEVANT DOCKET ENTRIES

July 1, 1974	Opinion of the District Court (Bankruptcy), Judge Don C. Miller.
September 9, 1974	Judgment of the District Court (Bankruptcy), Judge Don C. Miller.
September 8, 1975	Memorandum Opinion and Order of the District Court, Judge Thomas D. Lambros.
September 9, 1975	Judgment of the District Court, Judge Thomas D. Lambros.
April 5, 1977	Opinion and Judgment of the Court of Appeals.
June 23, 1977	Petition for a Writ of Certiorari Filed.
October 3, 1977	Certiorari Granted.

TRANSCRIPT OF TESTIMONY

No. B 70-4787

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

(Title Omitted in Printing)

* * * * *

[23] JAMES R. McLAUGHLIN called as a witness on behalf of the Debtor, being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION OF JAMES R. McLAUGHLIN

By Mr. Carlisle:

Q. Mr. McLaughlin, would you state your full name and address, please? A. James R. McLaughlin, 1210 Bell Avenue, Lakewood, Ohio.

Q. And your position? A. I am a Revenue Officer with the Internal Revenue Service.

Q. Are you familiar with the filing of the various claims in the real estate arrangements provision of Ike Slodov? A. Yes.

* * * * *

[38] Q. You told them in no uncertain terms that current withholding taxes and withholding Social Security had to be paid? A. And I might add that we did that even in the face of the liabilities being old. The first thing we were concerned with was that no more taxes were being accrued.

Q. That's right, and was the intent stated to you that the current withholding, as it accrued, both taxes and Social Security was going to be paid? Isn't that correct? Didn't they tell you that? A. Yes, they would have told me that certainly.

* * * * *

[81] WILLIAM J. MOLCHAN called as a witness on behalf of the Government, being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION OF WILLIAM J. MOLCHAN

By Mr. Mitchell:

Q. Would you state your name and present address? A. William J. Molchan, M-o-l-c-h-a-n, 3201 Wales Avenue, Parma, Ohio.

Q. By whom are you presently employed? A. Zagar Tool.

Q. How long have you been with them? A. Almost four years.

Q. Were you involved in the business known as either Tas-tee Catering or Russell's Foods? A. Was I involved?

Q. Yes. A. Yes, I was.

Q. For what period of time? A. A little over a year, from around the 1st of March of '68 until June 1st or 4th of '69.

Q. Do you recall when Dr. Slodov came into the business? A. Yes, I do.

Q. When was that? **[82]** A. January 31st of '69.

Q. As you understand it, how did he come into the business? A. We were called in by Russell Pishnery and advised that the company had been sold to Dr. Slodov and his associates, and at that point in time a couple of members of the new group were introduced, but I don't believe Dr. Slodov was at that point.

I don't recall meeting him until a few days later.

Q. What was your role in the business? A. I was accounts payable supervisor primarily, the title I had, but generally speaking, I was paying bills.

Q. You are basically an accountant then? A. Yes, I am.

Q. How would you describe the role that Dr. Slodov played in this business? A. He was the principal.

Q. He was the principal? A. Absolutely.

Q. If you could be a little more specific, what did he do? What decisions would he make? A. Well, Dr. Slodov, the first few days I was under the direction of Mike DiDomenico who was still [83] exercising authority over the office, and although I had seen Dr. Slodov around, I really didn't know his name.

I didn't know which gentleman was Dr. Slodov, and then about a week later I met Dr. Slodov in his office on a Sunday, and he advised me he wanted me to remain. We worked with them, and he would be in charge of all my future directions rather than Mike.

* * * * *

[84] Q. Mr. Molchan, you were describing a meeting you had on a Sunday with Dr. Slodov and what he told you. A. He just introduced himself and said who he was and said he was going to function as the leader. I was going to be working with him, and he was going to retain my services, and generally, asked me to cooperate with him and try and do what I could to help.

Then they had another meeting which I went out and attended that same day. That was the same day.

Q. Did you subsequently take direction from Dr. Slodov? A. Yes. Dr. Slodov and Mr. Catania. Dr. Slodov wasn't there every day, because he had a practice, and sometimes he contacted me by phone. Sometimes he left [85] me a note and sometimes came through Mr. Catania or Mr. Surckla, but I was advised generally any desires he had that he wanted me to do.

Q. Were you ever given a direction as to what creditors would be paid and what creditors were not to be paid? A. Almost immediately the direction was to pay the bills due. First a list would be made up daily, and this entered another gentleman, I think Mr. Mellinger made this, if I recall correctly, a list of what we needed, and these were primarily the bills we would meet.

We were paying for those bills because things were difficult and we weren't able to get merchandise freely, so there was a list with what was needed from different vendors, so we had a list of the amount that we could afford to pay to get the merchandise, and Dr. Slodov was involved in that, as were all of us, I suppose.

Q. And it was your job to then try to pay these creditors? A. That's correct.

Q. In order to obtain merchandise? A. That's correct.

Q. Are you generally familiar with the provisions [86] in the Internal Revenue Code for payment of FICA taxes and withholding of employees, withholding of FICA taxes? A. I am.

Q. And for the withholding of federal income taxes? A. Yes, I am.

Q. Who in the business was responsible for withholding and collecting for those taxes? A. We were withholding them in the Payroll Department, and in the beginning Dr. Slodov had—

Judge Miller: Just a moment. The Court would like to know what period of time you are talking about.

Mr. Mitchell: I'm sorry.

Q. Let's limit this in this case between January 31st and July 15th, or more specifically, the time you left, which was the first week in June. A. Well, to begin with, it seemed like we were totally aware for the need to provide for taxes, so incorporated in the list, we always said, Dr. Slodov said we needed to set aside certain funds, as much as possible, and he had designated certain amounts, maybe $300 a week for this or whatever, to be provided to pay income taxes, so when we did fail our 941's, the funds would be there. So we endeavored to set up **[87]** different accounts other than the National City accounts where we would apply a few hundred dollars at a time.

Now, generally speaking, this is not easily done due to the circumstances of the corporation at the time.

Q. Go into those circumstances a little more. A. If we wanted to pay a tax on a given day and we couldn't quite come up with the money because we either didn't collect it or we had an emergency need for some kind of merchandise, we would defray the payment of the tax at that point, because we really didn't owe it at that point. The corporation didn't really feel they owed it at that point because the tax is next week, and they would buy something and then next week they would endeavor to do something about it.

This was a struggle, but provided in the whole thing that taxes were—we were going to have this to meet them, and by and large they were always included in the list, but not always paid according to the list.

Q. You left the business in June of '69. Would you describe the conditions under which you left? A. Well, I wasn't always in agreement with the way money should be paid or not paid, and at this **[88]** particular time there was a period of time when Dr. Slodov was not in charge of the corporation according to, you know, the other officers, and an emergency arose; wherein, we either had to spend money for taxes or spend money for merchandise, and the people involved, meaning the other officers other than Dr. Slodov had decided that they were going to close the plant or some such decision and had advised me that we are going to pay the payroll and the taxes and close up.

At this point in time there was a meeting; wherein, Dr. Slodov didn't want to close the plant, and he signed some affidavit— I don't have the information exactly— but it was to the effect that he was taking over and being responsible for the liability of the taxes, et cetera.

We went out to Mr. Carlisle's house one evening and this was consummated and signed by Dr. Slodov, that he would be responsible for all liabilities and whatever they were at the point, and we tried to talk him out of it.

I don't know exactly what it said, but to the effect that he was going to take over the responsibility, and it was shortly or the next day or so, that Dr. Slodov asked me to take a vacation, and I didn't want to take it, at least I didn't want to take a **[89]** vacation.

I either had to stay on and do what I could or get out, and I quit. I didn't come back other than to pick up my stuff.

Q. You indicated that you said that money had to be used to pay taxes or otherwise. Was there a fund of money actually accumulated? A. We did have some funds. There was some that Mr. McLaughlin alluded to in the Lake County Bank. We had, downstate, like in Akron and Canton, depositing funds, and we left them set there as long as possible, so when the quarterly return would be filed, that is what we did the first quarter, and we applied those to the residue of the balance due. We applied it when we filed in April, and we were trying to do the same thing, as a matter of fact, with the downstate funds, Dayton, Akron, Canton area, and I recall there was about $30,000 involved in this deal that occurred around the 1st of June, and how to use it became a problem.

Q. What did Dr. Slodov want to do with the money? A. I assume he bought merchandise.

Q. Do you know what he wanted to do with the money? A. I think he wanted to buy merchandise. He **[90]** wanted to keep the place open.

Q. Do you, in fact, know what became of the money? A. No, I do not.

Mr. Mitchell: Your Honor, I don't have any further questions of Mr. Molchan.

CROSS EXAMINATION OF WILLIAM J. MOLCHAN

By Mr. Carlisle:

Q. Mr. Molchan, you indicated that you had charge of the accounts payable. You had that struggle? A. That is certainly true.

Q. One of the things we are talking about, Mr. Molchan, is a preference of other creditors over paying Internal Revenue. Do you recall any creditors who were given preferential payment? A. Nobody was given preferential payment, only merchandise bought, but not preferentially.

Q. You don't recall bringing anybody current on installment payments? A. Nobody was brought current.

Q. Or payment of license plates that were a year old? A. Nobody was brought current.

Q. Do you recall actually what happened between **[91]** February and July or February and the time you left? Let's refer to some specifics. You had a monthly obligation in the neighborhood of $8 or $9,000 to Union Bank and Commerce? A. We didn't pay it.

Q. They held a pledge of stock of the Charles Corporation, didn't they? A. Correct.

Q. First National Bank of Canton, there was an obligation down there. Do you recall if they were paid regularly? A. Not regularly.

Q. Cleveland Trust, you had a very sizeable equipment loan there; isn't that correct? A. Positively.

Q. Do you know what condition they were left in? A. Extremely bad. They made a levy.

Q. Do you recall Horton Dairy? What was Horton Dairy? A. As I recall, some $80,000.

Q. They took judgment for it, didn't they? A. Yes.

Q. Did you make any preferential payment to them? **[92]** A. Not other than say four percent beyond what they were producing or some such thing.

Q. Do you recall a $100,000 payment to a company by the name of Metropolis Industries? A. I know of it.

Q. Do you recall how that loan came about? Do you know when it was? A. Let me explain first that I was not directly involved in that general ledger area. It was Mike DiDomenico's responsibility, but when the loan was taken, it was at a time when taxes were due also, and I—

Q. Withholding taxes? A. Withholding taxes, and I always heard from Mike that this was an absolute type note, and was like a hammer over the corporation.

I never saw the note, and I never heard any more about that note until after Mike left.

I got one of these sheets like that one there, a legal size paper, that had it itemized on that as a payment in the first week in February, in 1969, and frankly, I was floored at $100,000 going out at that point.

I don't know who made the decision. I don't know who signed the check, but I do know they paid **[93]** $100,000 in the first week in February to this company.

Q. By an absolute type, what do you mean? You were not implying any mafia or anything of that nature? A. Not to my knowledge.

Q. What about National City Bank? They had a demand loan, didn't they, for $250,000? A. I really didn't get into that until after Mr. McLaughlin came out and things got really tough, because apparently that was handled in December by the doctors involved in the prior ownership, and there was a $225,000 note involved there.

Q. Do you remember what that was taken out for in December? A. I would think it covered the overdraft of 1968, third quarter payment of taxes.

Q. And do you recall, as the accounts payable accountant there, do you recall paying anything on that National City Bank loan? A. No, I do not.

Q. Mr. Molchan, you indicated that a list was set up by Dr. Slodov to make deposits or set aside funds on a daily basis, and that included on that list was money for withholding taxes. A. That's correct.

Q. But this is money, you were setting aside **[94]** money in advance here, is that correct? A. That's correct.

Q. So in other words, this money you were setting aside was actually being set aside on a daily basis prior to a payroll withholding; isn't this correct? A. If I may clarify, we didn't physically set aside money. The catering business and the vending business had a numerous number of banks that they were depositing rather than carrying them in the central depository there, and we didn't transfer certain funds to the distribution center in order to leave them there for payment of taxes.

That is the way we really left it there. We didn't take a check and write $100 to bank so and so. We didn't transfer the funds to be used to—

Q. What you were doing then was segregating or withholding those funds from the National City Bank, generally disbursing or a general account? A. That's correct.

Q. And this was part of the original plan that was set up? A. That's correct.

Q. And as far as you know, to the best of your ability and to the best of Ike Slodov's ability, **[95]** was an attempt made to follow through on this plan? A. There was an attempt.

Q. And in fact didn't it get to a point in March and in April and May where despite the plans that had been set up, your checks started bouncing on a National City Bank account? A. Yes.

Q. Do you recall what caused that? A. Well, the first time we had trouble with it was over the milk bill. When they took some judgment, National City grabbed the funds that they had there and we couldn't use the account. It was several days of problems there where we were using the cash right out of the till there, right out of the collection to buy whatever we were using at the point that we needed it. There was no way we could transfer. This precipitated a problem, wherein, we could not use checks very effectively unless we were in the bank seven days. They wouldn't just accept a payment check, so people began asking for certified checks, and in some ways that is how we gave many of our checks to the IRS, in certified form, taking cash down in cars to deliver to National City to get a check to pay. We did that not only with IRS but with other people as well.

Q. So in following again this general scheme **[96]** of daily or weekly or setting aside money and actually depositing money to pay Internal Revenue withholding, you got to the point where then you had to change your cash and currency into certified funds, and then take those checks down to Internal Revenue; is that correct? A. That is after the lien of the IRS, put a lien on, and after that we pretty much operated on almost a cash basis, because we couldn't get checks—no one would accept our checks.

Q. Do you recall how long a period of time this went on? A. I do believe that was probably the last month I was there. It started—I wish I could remember it—May 8th is very important to me because it is the day the check didn't clear the bank. We issued, I think, it was May 8th when it really got bad, and the whole month of May was bad.

Q. You were a corporate treasurer during this period of time, were you not? A. Yes.

Q. Did you receive anything other than your normal salary? A. No, sir.

Q. Was there an occasion or two when you didn't receive your salary? **[97]** A. Yes, sir.

Q. You are still carrying a check around? A. Yes, sir.

Q. It has never been cashed? A. Never will be.

Q. Do you recall what pay period that was for? A. It was one of the ones where we couldn't make the payroll. I got paid for the last one.

Mr. Carlisle: I have nothing further.

Mr. Mitchell: May I ask a couple more questions?

Judge Miller: Yes.

RE-DIRECT EXAMINATION OF WILLIAM J. MOLCHAN

By Mr. Mitchell:

Q. You said monies were set aside in the outlying banks. A. Yes, sir.

Q. What became of those monies? A. Well, in a couple of instances, they were closed out by the IRS, and we didn't go any further with that because we had gotten to the point where we couldn't use a check anyhow to transfer anything else. The banks would grab them, so we began to take cash **[98]** monies back and forth. There were some funds that might have been down in Akron or Canton. I don't know how far Mr. McLaughlin went with his lien.

I know we were surprised when we hit Lake County, because we had a check out there that didn't go, and there were funds there for it.

I don't remember what it was, but some kind of payment, and then we had a bank account in Cleveland Trust, I think they liened on, and took the funds, so these deposits in the outlying areas were basically—they didn't get very far.

You have got to realize we are talking about a short period of time. I think Jim McLaughlin showed up on the 10th or 11th of April, and by May 9th or 10th we were in bad condition, because he made his moves on liens and what have you, and the incidents of the milk company had done us no good.

So checks were not very viable at that point in time. We were handling cash extremely dangerously, Mr. Surckla particularly involved.

Q. Let me get this straight. Was it not until then when Mr. McLaughlin came out that this effort was made to withhold the checks? A. No. We made some payment prior to that. See, we did make some payments in February and in March **[99]** of these funds. They have the figure, but as we went along, we made some payments of the funds and we would transfer them into National City Bank and write a check, and I would tell Mr. Williams that these were funds we were going to pay out into Internal Revenue.

We tried to follow a pattern until we couldn't do it anymore, but in the early stages, like when we paid $5,000, and I recall the incident when Mr. McLaughlin came out and we gave him two checks for $5,000, each for two different corporations, these were part of the funds we set aside, and later we made more payments. They weren't even amounts because whatever we transferred, we got a check or cash for it.

Q. Incidentally, you spoke of a Mr. Williams. Now that is a gentleman in the bank? A. Yes.

Q. He is not a Revenue officer? A. No, sir.

Q. You had also indicated to Mr. Carlisle that you brought none of your creditors currently—I believe that was your phrase. A. None of our creditors were current.

Q. Right. During the period, again January 31st to your departure, were payments made of some bank debts to your suppliers? **[100]** A. We endeavored. There was an agreement made with our suppliers that those who were—and I assume it was most of them—that when we did make a check out, we would endeavor, I think it was a four percent return on what was past due.

This agreement was made. It was extremely difficult to live with. We just couldn't live with that. It was part of the problem.

We couldn't pay those kinds of back bills, but the officer in charge of that particular negotiation made those terms, and some of them made us live with it. We couldn't get anything unless we paid it that way.

Q. And we have been speaking of daily or weekly deposits. How much money would the business deposit in a week? A. After January 31st it ran about $130,000.

Q. A week? A. Yes. It deteriorated later, but during the month of February, I would say, and probably March, it ran $130,000. Then it went downhill.

Mr. Mitchell: That completes my questioning.

Mr. Carlisle: Nothing further.

* * * * *

[127] JAMES McLAUGHLIN was recalled as a witness, being previously duly sworn, was examined and testified further as follows:

* * * * *

[135] DIRECT EXAMINATION OF JAMES McLAUGHLIN

By Mr. Mitchell:

* * * * *

[144] Judge Miller: And you told the corporate officers to pay, to keep the taxes current?

The Witness: Yes.

Judge Miller: You didn't tell them just to pay the trust fund portion?

The Witness: No.

* * * * *

[154] DR. IKE SLODOV was called as a witness, being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION OF DR. IKE SLODOV

By Mr. Carlisle:

Q. Dr. Slodov, would you give your full name and address, please? A. Ike Slodov, 30026 Gates Mills Boulevard, Pepper Pike.

Q. Your occupation? A. Orthodontist.

Q. How long have you been an orthodontist? A. 12 years.

Q. Bringing your attention, Dr. Slodov, to the purchase of the stock of Russell's Foods or Tas-Tee Catering in January of 1969, did you sign a purchase agreement to purchase the stock of Tas-Tee Catering? A. Yes, I did.

* * * * *

[270] RE-CROSS EXAMINATION OF DR. IKE SLODOV

By Mr. Mitchell:

* * * * *

[272] Q. Please. A. On February 3rd, when we called the Service on the 11th, when we talked to them, if they at that **[273]** time had said, "Hey, let's stop everything," and we went there and had a meeting and we sat down and talked about football and who was best and who was worst, and we spent maybe three hours there all morning. Right there they had a choice. They could have told us: "Hey. You can't do anything but pay us."

We would have done just that or else we wouldn't have gone on, but they told us: "Hey. Go and operate the business. Do the best you can and we will go along with what you say."

What did we say we were going to do? We said we were going to take monies and make the deposits, and we were going to try to set monies aside towards the back taxes.

That is what they told us to do. That is what we went and did. Then the Metropolis Industries thing came up. We were told—

* * * * *

[294] JAMES McLAUGHLIN was recalled as a witness, being previously duly sworn, was examined and testified further as follows:

DIRECT EXAMINATION OF JAMES McLAUGHLIN

By Mr. Mitchell:

* * * * *

[310] Q. You were describing your discussions with the taxpayer and paying off current taxes.

Would you state again what you had instructed or requested or indicated to the corporation insofar as current taxes are concerned? A. I would like to—

Mr. Carlisle: Excuse me. I missed the question. I am sorry.

Judge Miller: Will you repeat the question, Mr. Reporter?

(Question read.)

A. Again, of course, I have to have my memory serve me, and I can't specifically recall every little thing.

However, I can rely on what I would normally do, and I probably did it in this instance.

If in any kind of situation like this, this is certainly a jeopardy type of situation. We have got a large liability. We have got a corporation that accrued more liabilities, and there has got to be some judgment made as to what are we going to do with this.

[311] Well, the usual way we would approach these is that we will—I shouldn't say ignore, but we will set aside the delinquent liability for a moment to make sure there is no more liabilities accruing, and this would be the first thing we would do is to prevent any further liability.

* * * * *

OPINION OF THE DISTRICT COURT

(Filed July 1, 1974)

Case No. B70-4787

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN THE MATTER OF:

IKE SLODOV,
Debtor

In Proceedings for a Real Property Arrangement under Chapter XII

OPINION

STATEMENT OF FACTS

(Filed July 1, 1974)

Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee Vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.

During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient monies in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately. Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.

There was a provision in the agreement of sale whereby Ike Slodov agreed to hold harmless the four sellers from payment of certain tax liabilities of Tas-Tee Catering. The following is the provision of the agreement of sale:

> "Buyer shall hold Sellers harmless from and against all loss, liability, damage or expense arising out of any claims, demands, penalties, fines, taxes or other loss resulting directly or indirectly from the assertion against Russell's Foods, Inc. of claims by the Federal Government, State Government, County Government or City Government for taxes and assessments. Buyer expressly acknowledges their understanding that there is an obligation of Russell's Foods, Inc. to pay taxes in the approximate amount of $250,000.00 on or before January 31, 1969."

Debtor Ike Slodov introduced at the hearing of this issue Exhibit 7, wherein the same four selling shareholders dismissed all claims against the debtor relating to such stock purchase agreement.

The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828)."

Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970.

THE ISSUES

A) Is the claim of Internal Revenue Service based on the theory of third party beneficiary under the "hold harmless" paragraph of the agreement, wherein the debtor Ike Slodov agreed to hold four sellers harmless from payment of certain taxes of Tas-Tee Catering, a valid claim?

B) Were the acts of the debtor Ike Slodov intentional and willful under Section 6672 of the Internal Revenue Code?

DISCUSSION OF THE ISSUES

> "As in the case of other types of claims, a filed proof of a tax claim in proper form establishes a prima facie case for the allowance of the claim. The burden of proof is on the claimant, but the burden of going forward and introducing evidence to rebut the prima facie case is on the objecting party. . ." *3A Collier on Bankruptcy, §64.409.*

The objecting debtor carried his burden of going forward to rebut the prima facie case as to each of the two claims.

Claim No. 80 in the amount of $229,511.58 is filed as an unsecured claim based on the theory of third party beneficiary under the agreement for sale of the Tas-Tee Catering stock wherein Ike Slodov agreed to hold four individual sellers harmless from payment of certain tax liabilities of Tas-Tee Catering and related companies.

The debtor Ike Slodov introduced Exhibit 7, wherein those same selling shareholders dismissed all claims against the debtor related to such stock purchase agreement. It should be noted that such persons acknowledged in Exhibit 7 that the so-called stock purchase agreement "shall be considered null and void."

It is well settled that "in order that a third person may enforce a promise made for his benefit, it must appear that the contract was made and entered into directly or primarily for the benefit of such third person." (11 *O. Jur 2d, 426, Contracts* §177; also see 17 *Am Jur 2d, 727,* *Contracts* §304, entitled "Necessity of, and what constitutes, intent or purpose to benefit third person.")

The debtor Ike Slodov testified that when the agreement was signed, he had no intent to benefit the Internal Revenue Service and that the agreement was solely for the intended benefit of sellers and debtor personally.

Claimant offered no testimony or evidence whatsoever to carry its burden of proving the following:

1) That there is in existence a valid enforceable contract;
2) That provided there was a valid contract, there was intent to "directly or primarily" benefit claimant;
3) That it had valid claims against the sellers and had collected or had the ability to collect from such sellers, thereby invoking the hold harmless provision—again provided it were part of a valid agreement.

The evidence disclosed that the debtor took command of the company on January 31, 1969, and that there were numerous conferences in which the debtor emphasized that money should be set aside for the payment of taxes. Within five weeks thereafter, the debtor had deposited $42,000 in the Lake County National Bank for the purpose of paying Internal Revenue Service. At that time he called Internal Revenue Service stating that the $42,000 was in the Lake County National Bank for the purposes of paying the taxes. The next day Internal Revenue Service attached the $42,000. The debtor had charge of the company for less than six months, and at those periods he or his accountant had numerous conferences with Internal Revenue Service attempting to solve the problem of taxes.

A. *Claim No. 29—Withholding and FICA (personal) taxes in the amount of $445.69*

Debtor rebutted this personal claim by his testimony that he had never been notified of a deficiency claim on his withholding; that he had always paid his employees' withholding when due; that Internal Revenue Service had audited his withholding and personal tax returns through the claimed 4th quarter of 1969 and had determined a refund of $6,674.84 due him; that such refund had actually been held by Internal Revenue Service for application to one of the Tas-Tee accounts.

Debtor's independent accountant testified she had participated with an Internal Revenue Service agent in such audits and that no finding or claim had ever been made for such withholding and that as late as November 19, 1973, the date of the latest correspondence from Internal Revenue Service (debtor's exhibit 9), no claim had been made for such tax.

The United States failed to give any direct testimony or explanation of such tax claim and wholly failed to carry its burden of proof on such portion of claim no. 29.

B. *Claim No. 29 as supplemented—100% penalty (Section 6672), Charles Corporation, Tas-Tee Catering and Tas-Tee Vending withholding tax and withheld FICA*

In Section 6672, Congress has provided the Internal Revenue Service with an extraordinary collection tool. A responsible officer can be held *personally* liable for payment of a corporate debt. Congress has declared that an employer must withhold federal income tax and social security from payrolls. Such withheld funds become *trust* monies for which the employer is merely a custodian until paid. The claimed failure by debtor to pay such trust funds (withholdings) must have been *willful*. Congress in its wisdom granted a responsible officer such protection.

The Courts have long recognized the requirement of proof of willfulness in Section 6672 cases. One of the outstanding cases is *Ferguson, et al. v. Warren*, 63-2 USTC ¶9783 (W. Dist. Wash., 1963). This case involved a suit for refund of taxes paid under a 6672 assessment. The jury returned a verdict in favor of the taxpayer-plaintiffs and found that they did not willfully fail to pay the Government income and social security taxes withheld by a corporation. In its charge, the Court stated:

> ". . . The responsible person must have known the taxes were due and consciously and deliberately disregarded payment of them, having funds within his control with which to do so. . ."

When and how were the claimed withholding tax liabilities incurred? The claim (adding the three companies together) shows the following:

$313,740—Total claim

$26,974 is reported as due on *2nd quarter 1968*.

Debtor took control on January 31, 1969. The exhibits and testimony showed, as of that date, there were *no liquid assets—no escrow accounts or tax depository accounts*. In fact, there was *no evidence* by the claimant that the $26,974 had been withheld. Obviously, if the funds had been withheld, they had been used long before by prior management.

$150,362 is reported as due on *4th quarter 1968*.

Debtor's management was not in the companies in those months. Again, *all the evidence* demonstrates that by the time debtor took control, any withheld tax funds or any other liquid assets were long gone.

$?—January, 1969.

Internal Revenue Service has not provided a breakdown on this period of time during which the companies failed to deposit or otherwise hold the withheld taxes for payment. Again, *debtor had no responsibility under Section 6672 during January to withhold and had no control of such monies*—none were on hand on January 31, 1969.

Is the debtor liable for the above withholdings under some theory other than as a "responsible" officer during those periods?

Section 6672 is the basis of this claim and is silent as to any basis other than responsible person who willfully fails to pay over such funds. Again, *DEBTOR WAS NOT A RESPONSIBLE OFFICER PRIOR TO JANUARY 31, 1969, AND AT THAT DATE CONTROLLED NO SUCH TRUST FUNDS.*

Did debtor assume some contractual liability with Internal Revenue Service by signing the 4th quarter 941 return and by signing company checks on overdrawn accounts? The 941 form, the checks, and the total evidence presented by claimant supports no such assumption of contractual liability and no such contractual liability set forth in this claim nor in Section 6672.

Computed from the claim on file, *at least* $177,336 of this claim *IS ON WITHHOLDING DURING 1968*. That leaves approximately $137,000 for all of 1969, and some undetermined amount of the $137,000 represented January, 1969, withholdings. How much of the $137,000 was *employer's FICA* tax covered by application of *employees'* withholdings?

One matter was made clear by James McLaughlin, the Internal Revenue agent—But for his application of funds paid after February 1, 1969, to corporate share of FICA, *there would have been no withholding tax deficiencies subsequent to February 1, 1969.*

Examination by debtor's counsel of Internal Revenue Service of amounts of withholding tax withheld after February 1, 1969, demonstrated such total as $253,533. This was the total *trust* money withheld as both income tax and employees' FICA, and this was the total required to be withheld under debtor's management.

Debtor's evidence and Internal Revenue Service testimony showed ***$249,212 was actually paid by debtor's management.***

$253,533—withholding liability

$249,212—withheld and delivered to Internal Revenue Service

The above figures standing alone are startling, overwhelming and convincing proof that debtor established a system of withholding, segregating, and paying the withholdings and that the system was followed.

Amid times of the most extreme financial stress and chaos imaginable, debtor's team withheld the taxes, set them aside in special accounts and delivered the funds to Internal Revenue Service.

The above comparison is most impressive to demonstrate *willfulness to pay* when compared to the corporate records of total *NONwithholding* and *NONpayment* in 4th quarter 1968 and January, 1969.

Debtor's testimony together with testimony of government witnesses, Mr. Molchan and Mr. Surckla, showed

that the withholding funds were delivered to Internal Revenue Service with the common understanding and agreement that these were withheld funds—trust funds—and were being delivered in that form and to cover those liabilities. The government is certainly bound by its own testimony.

As to application of these withholding monies, it is clear from all the testimony of Mr. McLaughlin and from the law that the withholding monies should be applied to withholding liability in accordance with the understanding of the officers of Tas-Tee and Internal Revenue Service. Mr. McLaughlin followed this understanding on several occasions and did apply funds to withholding liability, although there existed at that same time, extensive corporate liability for employer's FICA as well as prior withholding tax liability. He followed this understanding and agreement in several major payments of the funds segregated, levied upon and released and voluntarily paid from the Lake County National Bank depository.

The Court in *Hewitt v. United States*, 377 F. 2d 921, (1967), United States Court of Appeals Fifth Circuit held, in very broad terms, that absent any agreement, direction, or request, the Internal Revenue Service had a right to apply funds of a corporation as it saw fit to federal income and social security taxes which had been withheld from employees.

It was obvious from the testimony of government witnesses (Mr. Molchan and Mr. Surckla), that there was such an understanding, agreement, and request to Internal Revenue Service for application of the withholding taxes to current withholding liabilities.

If the Internal Revenue Service chose, in its wisdom, to make an application of withholding funds to nonwithholding liabilities, it did so purely as a collection procedure. Its actions, as such, would not in any event vary or affect in any way the obvious willful intent and willful action taken by debtor and his management *to pay the withholdings liabilities.*

> "An act is willful if it is voluntary, conscious and intentional. If you find the plaintiff voluntarily, knowingly and intentionally used available funds to prefer other creditors over the United States, then you must find that he acted willfully."
>
> *Monday v. United States,* 421 F.2d 1210, 72-1 USTC 9219 (E. Dist. Wisc., 1972).

The above is a statement of law given by the Court in its charge on a 6672 case.

The evidence presented by the government and by debtor showed:

1) That the debtor was in no way responsible for nonwithholding or nonpayment of withholding funds prior to February 1, 1969, as there were no such funds, or for that matter, any funds whatsoever existing upon debtor's arrival at the company;

2) After February 1, 1969, debtor's management *withheld* employees' income tax and FICA and paid such withholdings to Internal Revenue Service;

3) At no time did debtor voluntarily, knowingly, and intentionally use withholding or other available corporate funds to prefer other creditors over the United States; and

4) Debtor, by his instructions and procedures, demonstrated a *willfulness to withhold to account for* and *to pay over* the withholding taxes.

The claimant has failed in its burden to prove a willful failure to pay the withholding liabilities.

Does Section 6672 of the Internal Revenue Code impose a nonallowable "penalty" for purposes of the Bankruptcy Act? The effect of this Section is to penalize the bankrupt, or, in the instant case, the debtor; and although the Section itself provides that any responsible person who willfully fails to collect and pay over the withheld taxes is "liable to a *penalty* equal to the total amount of the tax . . . not accounted for and paid over," the actual purpose is not to penalize individuals, but to afford an alternative means of collecting a corporation's default in payment of employees' withheld taxes. The cases cited by the Government in its earlier brief of the subject, as well as its comments by way of post-trial memorandum, correctly reflect the law. Accordingly, it is not asserted that the claims should not be allowed by being designated as "100% penalty claims."

As to claim No. 80, on the basis of "third party beneficiary," for $229,511.58 for taxes due prior to February 1, 1969:

1) The contract between debtor and the four sellers is null and void and of no effect, by virtue of the dismissal with prejudice of the sellers' claims against debtor and the settlement agreement previously approved by the Court; and

2) Even if the contract was in effect, none of the selling shareholders in whose favor the "hold harmless" clause was written were ever considered liable under Section 6672 for withheld taxes by the Government, and thus, no right to recover from the debtor exists.

As to claim No. 29 for $445.69 for dental practice withholding, the testimony clearly established that this sum had been long paid and that nothing is due.

As to claim No. 29 for withheld taxes:

1) The debtor was not responsible for collection of withholding taxes until February 1, 1969. On that date there were no funds on hand for said purpose as the former owners had failed to withhold or segregate sufficient funds;

2) The debtor established a system of segregating funds for payment of withheld taxes and did, in fact, pay withheld taxes during the period February 1, 1969, to July 15, 1969;

3) *There was no willful failure* to pay over taxes as the evidence clearly indicated that the debtor, as a responsible person, and the officers of the employer-corporation *PAID THE WITHHOLDINGS* and had attempted to make it perfectly clear to the Internal Revenue Service that the payments were for current trust fund obligations. While this intention to pay was disclosed, the Government applied the funds as it saw fit contrary to said expressed intent; and

4) The mere act of signing 941 returns for periods prior to February 1, 1969, is not sufficient to render the signer liable as a responsible person under Section 6672.

Conclusion

The evidence disclosed that claim No. 80 in the amount of $229,511.58 is based soley on the contentions of the United States of America that it is a third party beneficiary under stock sale agreement of Russell's Foods, Inc, dated January 31, 1969.

The United States relied entirely on its claim as filed offering no additional evidence thereon.

Debtor produced evidence of agreement by all parties to such stock purchase contract that such stock purchase contract had been deemed null and void and of no effect and that the suit filed by the parties to the contract had been dismissed with prejudice. Debtor further testified that he and the parties signatory to the contract had no intent to benefit the United States of America. The United States offered no evidence or testimony contrary to debtor's evidence.

The contract wording further reflects no intent to benefit the United States of America. The United States further offered no evidence of payment of taxes by any of the parties to the stock contract and no evidence that any of such parties were responsible persons required to pay withholding taxes. Accordingly, there was, in any event, no showing of liability of debtor through operation of the purported indemnification clause.

The Court, therefore, sustains the debtor's objections as to claim No. 80.

Coming now to claim No. 29 as amended October 15, 1973, the Court notes that such claim is in the total amount of $313,740.79, of which sum $445.69 is attributable to Ike Slodov, employer No. 34-0909176, and claimed as a nonpayment of withholding and FICA for 4th quarter 1969.

The United States of America, claimant, relied entirely on its claim as filed together with claimant's Exhibit 1 entitled "Certificate of Assessment and Payment."

Debtor testified nothing was due nor had he ever been notified nor billed concerning the claimed deficiency and that all of his personal and professional tax returns had been audited through the year 1970 and prior with a finding that there was due debtor the sum of $6,674.85, which is verified as a credit to debtor on claimant's Exhibit 1. In addition, debtor's accountant, who had personally participated in such audit, testified that all 941 withholding tax returns including 4th quarter 1969 had been reviewed and audited by an agent of the Internal Revenue Service with no finding of irregularity, no deficiency, and in fact, that there had been found due debtor from Internal Revenue Service the above-mentioned $6,674.85.

The remainder of claim No. 29 is founded upon Section 6672 of the Internal Revenue Code, which provides:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

The testimony established that debtor and his management assumed control of the Russell's Foods companies after January 31, 1969, together with its bank accounts.

As to all withholding taxes prior to January 31, 1969, debtor was not a responsible officer or person charged with withholding and paying such taxes. His act of signing 941 withholding tax returns for 4th quarter 1968 and of signing checks to pay such taxes do not, under these circumstances, render him such a responsible person.

Prior to January 31, 1969, any taxes withheld had been spent on corporate debts or otherwise as shown by the negative bank balances at the date debtor wrote the several checks to Internal Revenue Service. Accordingly, at January 31, 1969, it is clear that there were no withholding trust fund tax monies or other funds over which debtor could assume control or responsibility.

The Court finds that as to payroll withholdings on or after February 1, 1969, and continuing to around July 15, 1969, debtor was the responsible person pursuant to Section 6672.

The Court further notes, however, that Section 6672 specifies that failure to withhold or pay over such withholdings must have been *willful*.

The following are a number of circumstances and evidentiary matters which have led this Court to a conclusion that there has been no willful nonpayment of withholding taxes:

1) After February 1, 1969 (and apparently for some time prior thereto), the entire corporate and financial situation of the subject companies was in a constant and serious state of turmoil. There was a history of suits, replevins, levies, and repossession threats and signers of bank accounts which enveloped the companies at the time of debtor's assuming control. Counsel for the United States during his examination of debtor appropriately termed the company affairs as a "horror story." Debtor was, therefore, working under the worst of possible conditions for obtaining a clear understanding of financial conditions and tax liabilities.

2) This Court is impressed with the record of payment of the companies after February 1, 1969. The fol-

lowing are the specific payments as shown from the exhibits and record of testimony taken by the Court:

TAS-TEE CATERING, INC.

PAYMENTS

Date (1969)	Amount
Various	$54,144.15
8-11	795.76
4-11	5,000.00
2-11	4,024.67
2-14	7,968.20
2-14	3,173.11
4-11	5,000.00
4-22	4,000.00
4-21	10,000.00
4-25	15,924.00
4-29	7,728.00
5-12	21,020.08
5-26	2,256.43
5-20	8,000.00
5-26	4,070.22
6-3	8,841.55
6-4	9,000.00
6-24	7,880.32
7-2	7,080.15

TAS-TEE VENDING, INC.

PAYMENTS

Date (1969)	Amount
5-27	$5,180.00
6-3	1,261.73
6-3	1,275.48
6-24	1,428.18
7-2	765.69

CHARLES CORPORATION

PAYMENTS

Date (1969)	Amount
2-11	$ 4,348.60
2-14	4,958.44
3-18	9,558.48
4-21	5,000.00
4-25	8,926.14
4-29	2,742.03
5-12	13,029.91
5-12	3,340.91
5-26	1,673.35
6-4	5,380.00
6-3	4,049.43
6-3	4,000.00
6-24	4,054.08
7-2	3,705.94

3) The Court notes that during February and March withholding taxes were being accumulated in a special depository at Lake County National Bank and that such depository was disclosed to Internal Revenue Service agents at the earliest possible time.

4) The testimony of the two corporate officers (Mr. Surckla and Mr. Molchan) who were Government witnesses, showed direct and firm instructions voiced by debtor to pay the withholding taxes.

5) The testimony of Mr. Surckla and Mr. Molchan vividly corroborated testimony of debtor as to the enormous effort of corporate employees to pay over such withholding taxes under circumstances where Internal Revenue Service would not accept corpo-

rate checks nor delivery of cash but insisted upon certified drafts. Corporate employees expended considerable time, effort, and risk in carrying carloads of cash to various financial institutions for purposes of counting and converting cash to certified drafts.

6) The testimony further showed that neither Mr. Surckla nor Mr. Molchan had been pursued by Internal Revenue Service as responsible persons under Section 6672 for personal payment of such taxes. Therefore, the Court notes that their testimony as to instructions and efforts to pay over such taxes is clearly nonself-serving and, as a result, left the claimants with a shallow case.

7) In addition to the above payments and attempts at payment, the evidence showed debtor immediately after February 1, 1969, contacted Internal Revenue Service and advised its agents of the discovery of the dire financial circumstances and solicited assistance or guidance from Internal Revenue Service.

Claimant has contended that payment of any other corporate debts after February 1, 1969, demonstrates willfulness of debtor to avoid payment of taxes. The Court notes that the decisions cited by claimant and by debtor refer to voluntarily, knowingly, and intentionally using available funds to *prefer* other creditors over the United States. The Court further notes that the payments shown of particular large amounts by claimant were with debtor's personal funds or personal funds deposited with the corporations by debtor. It is obvious that many bills incurred in the continuing operation of the corporations were paid for day-to-day expenses, it being noted that suppliers had placed the companies on a C.O.D. supply basis. There is no evidence that any creditor was preferred nor were they paid on arrearages. It should also be noted that Internal Revenue Service knew as early as the first week in February, 1969, that the corporations were in arrears in paying withholding to a sizeable amount. Internal Revenue Service knew that the companies were continuing in their operations and that it was necessary to purchase and pay for daily merchandise and other expenses.

The weight of the evidence shows an intent by debtor to pay over withholding taxes. The evidence may show nonpayment of some withholdings in small amounts after February 1, 1969, small amounts as compared to the entirety of withholding. It is clear to the Court that any such nonpayment was not willful.

The attorney representing Internal Revenue Service, Mr. Richard F. Mitchell, made a statement in open Court that the entire transaction of the sale of Tas-Tee Catering and affiliating companies to Doctor Slodov was a "horror story."

The Court therefore sustains the objection to claim No. 29.

Attorney for the debtor will cause a Journal Entry to be prepared giving expression to this decision. Submit the same to opposing counsel before submitting it to the Court, reserving therein exceptions.

/s/ Don C. Miller
Bankruptcy Judge

JUDGMENT OF THE DISTRICT COURT

(Filed September 9, 1974)

Case No. B70-4787

IN THE DISTRICT COURT OF THE UNITED STATES
For the Northern District of Ohio
Eastern Division

IN THE MATTER OF:

IKE SLODOV,
Debtor

In Proceedings for a Real Property Arrangement
Under Chapter XII

JUDGMENT

At Cleveland, in said District, this 9th day of September, 1974.

This cause came on to be heard upon the Debtor's Objections to Claim Nos. 29 and 30, as filed, amended and supplemented by Internal Revenue Service, the statements of counsel, briefs of law and the evidence. The issues having been duly considered, and a decision having been duly rendered.

IT IS, ORDERED AND ADJUDGED that the Objections of the Debtor to Claim Nos. 29 and 30, as filed, amended and/or supplemented by Internal Revenue Service, be and the same are hereby sustained, and judgment is rendered in favor of the Debtor thereon.

/s/ Don C. Miller
Bankruptcy Judge

MEMORANDUM OPINION AND ORDER OF THE DISTRICT COURT

(Filed September 8, 1975)

No. B 70-4787

UNITED STATES DISTRICT COURT
Northern District of Ohio
Eastern Division

IN THE MATTER OF:

IKE SLODOV,
Debtor

MEMORANDUM OPINION AND ORDER

Lambros, *District Judge*

This matter is presented for review of a decision denying the claims of the United States relating to a bankrupt debtor's withholding and F.I.C.A. taxes, the obligations arising from his orthodontia practice and from sums due under 26 U.S.C. §6672, the penalty provision[1] allowing assessment of taxes against an officer of a corporation.

The questions presented for review are these:

1. Was the debtor liable for withholding and F.I.C.A. taxes for the fourth quarter of 1969, in the amount of $445.69?

2. Was the debtor responsible for payment of federal withholding (trust fund) taxes for the second quarter of 1968 and the fourth quarter of 1968, as

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[1] The provision is not a penalty *per se* but rather an alternative tax collection device.

owed otherwise by Tas-Tee Catering, Inc., and related companies, and was his failure to pay willful?

3. Was the failure of the debtor to collect and to pay over federal withholding (trust fund) taxes owed by Tas-Tee Catering, Inc., and related companies during the period from February 1, 1969, through July 15, 1969, a *willful* failure?

4. Was there any agreement or understanding between the Internal Revenue Service and the debtor to the effect that moneys paid to the Internal Revenue Service would first be applied to the withholding portions of federal employment taxes, and if so, is that agreement enforceable in this proceeding?

I. QUESTION 1 FOR REVIEW

This claim is factually distinct from those raised in the other questions presented. The claimant seeks to recover $445.69 due as withholding and F.I.C.A. taxes for the fourth quarter of 1969, the obligation having its origin in the debtor's dental practice. The Government contends that the Bankruptcy Judge incorrectly placed the burden of proof upon the United States as a claimant and that the evidence presented was insufficient to sustain the findings made by the Bankruptcy Judge.

The Court finds that the burden of proof is properly placed on the Government when it seeks to collect a tax. The assessment of taxes is sufficient to establish a prima facie case forcing the debtor to go forward with evidence to rebut, but the United States as a claimant seeking to collect taxes has the burden of proof. *Bar L. Ranch v. Phinney*, 426 F.2d 995 (5th Cir. 1970); 3A *Colliers on Bankruptcy* §64.409. This was the standard applied by the Bankruptcy Judge and upon review of the evidence this Court cannot hold that the decision of that Judge based on the evidence presented to him was improper. *In re Mascolo*, 505 F.2d 274 (1st Cir. 1974).

The Bankruptcy Judge's decision on this issue is affirmed.

II. QUESTIONS 2, 3 AND 4 FOR REVIEW

The other three issues presented for review herein arise from the same factual background which in relevant part is as follows:

> Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee Vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.
>
> During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient money in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately.

Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.

. . .

The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:

> 'Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828).'

Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970. *Opinion, Date July 1, 1974, Pages 1 and 2.*

A. *Question 2*

The Government contends that the Bankruptcy Judge applied the wrong standard in determining whether or not the debtor's conduct was "willful" within the meaning of §6672. The Government is correct that the decision as to "willfulness" is not dependent on whether the responsible corporate official acted in bad faith or with improper motives. The test for "willfulness" in regard to §6672 is only whether or not the corporate official decided voluntarily not to pay the taxes owing. *Dudley v. United States*, 428 F.2d 1196 (5th Cir. 1970); *Bloom v. United States*, 272 F.2d 215 (9th Cir. 1959), *cert. den.* 363 U.S. 803. To the extent the Bankruptcy Judge applied another standard, his decision is reversed.

However, the Court finds that there is a more important issue which appears in the facts presented and which facts are not disputed by the parties. The debtor had no role in the corporations until January 31, 1969. He had no control over financial decisions. He had no opportunity to collect or direct collection of the taxes as they accrued. And therefore, under the clear and unequivocal language of §6672, he is not a "person required to collect, truthfully account for and pay over any tax. . . ." As the Court of Appeals for the Fifth Circuit observed in *McCullough v. United States*, 462 F.2d 588 (1973):

> The government here contends for a position which would, in effect, change the language of Section 6672 from 'person required to collect, truthfully account for, and pay over' to 'person required to collect, truthfully account for, or pay over.' The government thus seeks to fix liability on R.F. McCullough because he was president of the corporation during a time when sufficient funds came into the corporation's coffers,

> which, in cumulative amount at least would have been sufficient to discharge the corporation's liability for the unpaid taxes. The principal difficulty with this argument is that this is not the way the statute is written and there is no statutory authorization for the collection of this penalty, even though the taxpayer had free funds available for the purpose of paying the taxes. *McCullough, supra,* at 590.

Accordingly, the Court affirms the finding of the Bankruptcy Judge that the debtor is not liable under §6672 for the taxes arising during the 2nd and 4th Quarters of 1968, or during January 1969.

B. *Question 3*

The Government also seeks review of the Bankruptcy Judge's findings that the debtor did not act willfully in failing to pay the taxes due from February 1, 1969 through July 15, 1969. The Court, as noted in the preceding section, finds that the proper test for "willfulness" is whether or not the debtor voluntarily chose to pay creditors other than the United States. *Monday v. United States,* 421 F.2d 1210 (7th Cir. 1970), *cert. den.* 400 U.S. 821; *Werner v. United States,* 374 F. Supp. 558 (D.Conn. 1974); and *Stake v. United States,* 347 F. Supp. 823 (D.Minn. 1972).

From the evidence presented, the Court finds that the debtor did voluntarily elect to pay other creditors instead of the United States and for that reason, his conduct constituted a "willful" violation of the obligations imposed upon him.

The determination made by the Judge that the debtor's conduct was not "willful" as that term is used in §6672 is therefore reversed.

C. *Question 4*

The Government's final question for review is whether the Bankruptcy Judge's findings that there was in existence an agreement between the Internal Revenue Service and the debtor as to how the payments were to be applied were proper.

The taxes in question are employment taxes, which have both an employee and an employer share. The reach of §6672 is only to the employee's share, for it is only that portion the employer is obligated to collect and pay over, standing in a trustee-like relationship to the employee and to the Government.

Assuming that finding was an agreement as to the designation of the payments during 1969, this designation involved only the corporation, not its officers. The personal liability of the officers is in no way dependent on agreements with the employer corporation. *Monday, supra*; *cf., Spivak v. United States,* 370 F.2d 612 (2nd Cir. 1967), *cert. den.* 387 U.S. 908.

To hold otherwise would allow the officers of a corporation to convert those trust funds to business purposes and still avoid any personal liability. The intent of Congress to impose responsibility on corporate officers in charge of employment taxes is clear, and may not be frustrated by agreements involving the corporate employer.

The decision of the Bankruptcy Judge as to this issue is accordingly reversed.

III. CONCLUSION

The Opinion of the Bankruptcy Judge, entered July 1, 1974, is affirmed in part and reversed in part. The Court remands the case for further proceedings, to include recomputation of the debtor's obligation for 1969, the Court having found him not personally liable for the employment tax obligation arising in January 1969. The Court would further note that the claimant's contention that only $233,056.31 was paid on the 1969 obligations appears correct, the other $10,795.76 having properly been applied to 1968 corporate obligations. Thus further recomputation will be required to determine the exact sum owed to the claimant.

IT IS SO ORDERED.

/s/ Thomas D. Lambros
United States District Judge

JUDGMENT OF THE DISTRICT COURT

(Filed September 9, 1975)

No. B 70-4787

UNITED STATES DISTRICT COURT
Northern District of Ohio
Eastern Division

IN THE MATTER OF
IKE SLODOV,
Debtor

JUDGMENT

Lambros, *District Judge*

In accordance with the decision in the Memorandum Opinion and Order entered this date, this case is remanded to the Bankruptcy Court for further proceedings.

IT IS SO ORDERED.

/s/ Thomas D. Lambros
United States District Judge

OPINION AND JUDGMENT OF THE COURT OF APPEALS

(Filed April 5, 1977)

No. 75-2496
No. 75-2497

UNITED STATES COURT OF APPEALS
For the Sixth Circuit

IN THE MATTER OF SLODOV, DEBTOR IKE SLODOV,
Appellant and Cross-Appellee,

v.

UNITED STATES OF AMERICA on behalf of the
INTERNAL REVENUE SERVICE,
Appellee and Cross-Appellant.

Appeal From the United States District Court for the
Northern District of Ohio, Eastern Division.
Decided and Filed April 5, 1977.

Before: Edwards, Celebrezze and Lively, *Circuit Judges.*

Lively, *Circuit Judge.* These consolidated appeals concern the personal liability of a controlling officer of a corporation for income taxes and social security taxes withheld from the wages of employees but never paid over to the government. The controlling officer is now the debtor in proceedings for a real property arrangement under Chapter XII of the Bankruptcy Act. The following statement of the case appears in the opinion of the Bankruptcy Judge, 74-2 USTC § 9719, adopted by the district court in its memorandum opinion, 75-2 USTC § 9829, following a petition for review:

> Ike Slodov, the debtor, entered into an agreement for the purchase of the stock on the 31st day of January, 1969, of Tas-Tee Catering, Tas-Tee Vending, and The Charles Corporation. The above-named companies were sometimes referred to as Russell's Foods, Inc. However, for the purpose of this Opinion, the above-named companies will be referred to as Tas-Tee Catering. Ike Slodov assumed control and command of Tas-Tee Catering on January 31, 1969, and continued through the period from January 31, 1969, to July 15, 1969, except for a short two-week period from May 23 through June 4, 1969, when he withdrew from the company's direction.
>
> During the purchase negotiations, it was represented to Doctor Slodov that there was sufficient money in the treasury to pay all taxes and to pay the creditors for any outstanding bills. Doctor Slodov took charge the afternoon of January 31, 1969, and on February 1, the next day, sent out four company checks to Internal Revenue for payment of the liabilities. On Monday, February 3, Doctor Slodov discovered that there was no money in the treasury to pay the taxes and ordered a stop payment of the checks immediately. Doctor Slodov discovered that there was $100,000 owing to Horton Dairy and that there was no money in the treasury to pay them. The meat bills were unpaid, and the rental truck bills were not paid. The paper cup and plate companies were not paid and many other creditors. There was no money in the treasury to pay any of the above-mentioned debts.
>
> . . .

> The Internal Revenue Service filed its proof of claim for unpaid taxes in this case on November 2, 1970, and supplemental proof of claim on November 30, 1970. The initial proof of claim was amended on October 15, 1973. The Internal Revenue Service claims were based on Section 6672 of the Internal Revenue Code:
>
>> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. (Aug. 16, 1954, c. 736, 68A Stat. 828)."
>
> Ike Slodov, the above-named debtor, objected to the claim of the United States for Internal Revenue taxes filed herein on November 30, 1970, in the sum of $229,511.58, supplemental to proof of claim No. 29 filed on November 2, 1970.

The claim of the United States related to two distinct periods, one covering income taxes and social security taxes withheld from wages of employees ("trust fund taxes") prior to January 31, 1969 and the other being concerned with such taxes withheld after Dr. Slodov took control of Tas-Tee Catering on that date. Claim No. 29 encompassed both time periods, and the Bankruptcy Judge sustained Slodov's objections to that claim in its entirety.

Upon review, the district court affirmed the order of the Bankruptcy Judge with respect to that portion of Claim No. 29 which related to taxes withheld by Tas-Tee Catering prior to the time that Slodov took control, but reversed the order with respect to taxes withheld after control passed to him. Both parties have appealed.

SLODOV'S APPEAL

The taxpayer asserts that the district court erred in holding that he is liable for trust fund taxes of Tas-Tee Catering for the period from February 1, 1969 to July 15, 1969. This claim of error has two bases—first, that it is clear from the evidence that Slodov caused the corporation to collect, truthfully account for and pay over all trust fund taxes due to the United States for the period after January 31, 1969 during which he controlled the affairs of the corporation; and second, that there was an agreement between the Internal Revenue Service and the corporation by which payments during this period were to be applied to the current liability of the corporation for income taxes and social security taxes withheld from the wages of employees. The taxpayer testified at length concerning an agreement for the application of payments, and his testimony was supported by that of two former Tas-Tee Catering employees who were called by the government. The IRS agent in charge of the case testified that no such agreement existed and that if it did exist, IRS was not bound by it. He applied some of the payments to other tax liabilities of the corporation, including the employer's share of social security taxes.

The Bankruptcy Judge found that the total payments from Tas-Tee Catering to IRS during the period February 1, 1969-July 15, 1969 were virtually identical with the total liability for the corporation for trust fund taxes during that period and that except for the decision of an IRS agent to apply these payments to the corporate share of social security taxes, ". . . there would have been no withholding tax deficiencies subsequent to February 1, 1969." The Bankruptcy Judge also found that the payments made by Tas-Tee Catering to IRS during this period were made pursuant to ". . . an understanding, agreement, and request to Internal Revenue Service for application of the withholding taxes to current withholding liabilities." Even though the IRS agent testified that he was not bound by an agreement for the application of payments by a taxpayer, it is undisputed that several of the payments were applied in accordance with the agreement at a time when the corporation had extensive liability for its own share of current social security taxes as well as withholding tax liability for previous periods. The Bankruptcy Judge concluded from these findings that the trust funds taxes which accrued during the period of Dr. Slodov's control of Tas-Tee Catering were paid in full and that payment of other corporate debts during this period was not evidence of willful failure to pay withholding taxes since there had been no showing that corporate funds were intentionally used to prefer other creditors over the United States.

In reviewing the decision of the Bankruptcy Judge the district court did not refer to the finding that all trust fund liability of the corporation during the period of Dr. Slodov's control had been paid in full. With respect to an agreement between IRS and the corporation, the district court held that if such an agreement did exist it would not affect Dr. Slodov's individual liability under Section 6672. The main thrust of the district court's holding was to the effect that the Bankruptcy Judge applied an incorrect legal standard in determining whether or not Dr. Slodov's conduct in paying other debts of the corporation was willful within the meaning of Section 6672. Though the government contended otherwise in the district court, it now concedes that a designation by a taxpayer as to how a voluntary payment of taxes is to be applied is binding on the Internal Revenue Service. It continues to argue, however, that there is no evidence of an agreement between Tas-Tee Catering and IRS as to the application of payments and no evidence that a request was ever conveyed to personnel of IRS that the amounts paid should be applied first to the current trust fund liabilities of the corporation. It maintains that the findings of the Bankruptcy Judge are clearly erroneous.

If the district court had considered the findings of the Bankruptcy Judge, review would have been subject to Rule 810, Federal Rules of Bankruptcy, which provides:

> Rule 810. Disposition of Appeal; Weight Accorded Referee's Findings
>
> Upon an appeal the district court may affirm, modify, or reverse a referee's judgment or order, or remand with instructions for further proceedings. The court shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge of the credibility of the witnesses.

In *McDowell v. John Deere Industrial Equipment Co.*, 461 F.2d 48, 50 (6th Cir. 1972), we held that it is firmly established in this circuit that findings of fact of a Referee in Bankruptcy (now Bankruptcy Judge) should not be disturbed by a district judge unless there is "most cogent evidence of mistake or miscarriage of justice." A review of the evidence heard and received by the Bankruptcy Judge discloses ample support for his findings both with respect to the existence of an agreement for the application of the payments in question to current trust fund liabilities and that designations accompanied specific payments.

If the Internal Revenue Service had honored the agreement and designations found to exist by the Bankruptcy Judge, the corporation's liability for income taxes and social security taxes withheld from the wages of its employees during the period from February 1, 1969 to July 15, 1969 would have been satisfied. Since the payments by Tas-Tee Catering during the period of Dr. Slodov's control were virtually identical with the corporation's liability for trust fund taxes withheld during that period and these payments were made pursuant to an agreement that they be applied to current trust fund liability, Section 6672 of the Internal Revenue Code never came into play. The purpose of Section 6672 is to provide an additional remedy for the government in the form of a "penalty" tax against individuals responsible for the failure of a corporation to satisfy its tax liabilities. An individual who has caused the corporate obligations for trust fund taxes to be paid may not be held personally liable under Section 6672 because the IRS chooses to ignore a binding agreement and credits these payments to other corporate tax liabilities. *McKenzie v. United States*, 536 F.2d 726 (7th Cir. 1976).

THE CROSS-APPEAL

The district court affirmed the holding of the Bankruptcy Judge that Dr. Slodov is not liable under Section 6672 for income taxes and social security taxes required to be withheld by Tas-Tee Catering from the wages of its employees prior to January 31, 1969. The Bankruptcy Judge found from the testimony and exhibits that as of the date on which Dr. Slodov took control the corporation had no liquid assets and there were no escrow accounts or tax depository accounts. The Bankruptcy Judge held that Slodov was not a "responsible officer" prior to January 31, 1969 and that on that date no trust funds came into his control. In affirming the holding that Dr. Slodov was not liable under Section 6672 the district court stated:

> The debtor had no role in the corporations until January 31, 1969. He had no control over financial decisions. He had no opportunity to collect or direct collection of the taxes as they accrued. And therefore, under the clear and unequivocal language of § 6672, he is not a "person required to collect, truthfully account, [sic] for any pay over any tax. . . ."

The district court cited *McCullough v. United States*, 462 F.2d 588 (5th Cir. 1972), in which the court held that a person who had no responsibility for the collection of or accounting for taxes withheld during a particular period but who later controlled the corporation could not be held personally liable under Section 6672 for failure to pay the taxes to the government. However, we do not find *McCullough* to be dispositive of the issue on cross-appeal. The *McCullough* court found that the taxpayer never had available unencumbered funds with which to pay taxes that had previously been withheld and not paid over to the government. The court stated that it therefore did not "decide the liability of a person who becomes an officer responsible for the payment of withheld but not accounted for and not paid withholding and FICA taxes at a time when the corporation has funds from which the managing head of the corporation could discharge the defaulting corporation's trust obligation to the government and exercises his control to disburse such funds for other purposes." *Id.* at 590. The evidence is undisputed that Tas-Tee Catering had in its possession during the period of Dr. Slodov's control large sums of money which it used to pay debts and operating expenses. Therefore we must decide the question not reached by the Fifth Circuit in *McCullough*.

There is no doubt in the present case that Dr. Slodov knew that withheld taxes for periods prior to his taking control were unpaid. He attempted to pay these taxes with a corporate check immediately after assuming responsibility for the affairs of Tas-Tee Catering and later stopped payment on the check when he discovered that there were no funds at that time to make the check good or to pay other obligations of the corporation. In seeking affirmance of the district court on this issue the debtor argues that if funds representing taxes previously withheld by the corporation never came into his hands as a subsequent responsible party and no funds were available at the time he became the person in control of the corporate affairs, he may not be held liable under Section 6672. The government contends that there is no distinction between the position of a taxpayer who takes control of a corporation which has withheld taxes in its possession and dissipates them for other purposes and one who takes over such a corporation with no funds and uses money subsequently acquired by the corporation to pay other obligations to the detriment of the government.

An employee's income tax account and social security account are credited with the amounts reported by the employer as withheld for these purposes whether the employer pays them over to the government or not. The taxes required to be collected or withheld are intended by Congress to be treated as special funds held in trust for the United States. 26 U.S.C. § 7501; *Harrington v. United States*, 504 F.2d 1306 (1st Cir. 1974); *Spivak v. United States*, 370 F.2d 612, 615 (2d Cir.), *cert. denied*, 387 U.S.

908 (1967). The "willfulness" required for personal liability under Section 6672 exists if those with power and responsibility within the corporate structure for seeing that taxes which have been withheld are remitted to the government, acting voluntarily, consciously and intentionally, use corporate funds to pay other obligations rather than using them to pay withheld taxes. *Harrington* v. *United States, supra,* 504 F.2d at 1311; *Monday v. United States,* 421 F.2d 1210 (7th Cir.), *cert. denied,* 400 U.S. 821 (1970).

The Ninth Circuit dealt with a case similar in many respects to the present one in *Teel v. United States,* 529 F.2d 903 (1976). There responsible officers were found to have known that there were arrearages in payments of income and social security taxes in previous quarters, but they continued the operation of the business, using funds generated from the sales of inventory and manufactured products to pay for new merchandise. The court held that they acted willfully in failing to pay the taxes, stating ". . . as the cash went into the cash drawer, it became subject to trust or lien in favor of the federal government for the unpaid withholding taxes. By dissipating the cash for new purchases, of which the taxpayers knew, they unwittingly supplied the necessary willfulness." *Id.* at 905. *Teel* differs from the present case in that the taxpayers were responsible officers both during the time when withholding was required and when payment was due. However, we do not agree with those decisions which have indicated that personal liability under Section 6672 may only be incurred by persons who are responsible parties at the time withholding or collection is required to be effected as well as when reports and payments are required to be made. *See McCullough v. United States, supra,* 462 F.2d at 590.

We conclude that it is irrelevant whether there were unencumbered funds on hand at the time Dr. Slodov took control of Tas-Tee Catering. Prior to that time the employees of the corporation had received net wages which reflected withholding for income taxes and social security taxes. Whether these withheld taxes were segregated and held in special accounts or not they became trust funds for the payment of the withholding obligations of the corporation to the United States. When the corporation came into possession of funds after Dr. Slodov acquired control, these funds were impressed with a trust to the extent of the corporation's obligations for previously unpaid withholding income taxes and employees' share of social security taxes. Though created before Dr. Slodov's control of the corporation began, these obligations continued after that date, and he was clearly the person responsible for paying them when funds became available. In a different context this court has considered the meaning of the word "person" as it is defined in 26 U.S.C. § 6671(b) and referred to in § 6672. In *Mueller v. Nixon,* 470 F.2d 1348 (6th Cir. 1972), *cert. denied,* 412 U.S. 949 (1973), we decided to adopt a "broad interpretation" of the word "person" in order to give the full meaning to the intention of Congress. In the *Mueller* opinion the court quoted Section 6672 and then stated:

> As we read this section, it is squarely addressed to the person or entity responsible for the payment of the withheld taxes. It is knowledge of the tax delinquency and authority over the decision to pay or not to pay the taxes which is at issue—not who has the duty of filling out the forms. *Id.* at 1350.

Dr. Slodov clearly knew that Tas-Tee Catering had not paid income taxes and social security taxes withheld from the wages of its employees prior to the date that he took control of the corporate affairs, and when he caused subsequently acquired funds to be used for satisfaction of other corporate debts and payment of operating expenses instead of paying these preexisting obligations he exposed himself to personal liability under Section 6672. As the court stated in *Braden v. United States,* 442 F.2d 342, 344 (6th Cir.), *cert. denied sub nom. Bonistell v. Braden,* 404 U.S. 912 (1971)—

> If the appellant was aware of the fact that the taxes were unpaid, and, possessing the power and responsibility to pay them, failed to do so, then he is liable for the penalty of section 6672 notwithstanding his lack of malice or wrongful purpose. (Citations omitted).

It is immaterial that he was not in control of the corporation at the time it paid the wages from which the income and social security taxes were deducted. He did not "truthfully account for and pay over such tax" and this rendered him personally liable for the amount of the taxes.

The judgment of the district court is reversed on the appeal and cross-appeal, and the cause is remanded for further proceedings.

ORDER OF THE SUPREME COURT OF THE UNITED STATES GRANTING PETITION FOR A WRIT OF CERTIORARI

(Dated October 3, 1977)

No. 76-1835

SUPREME COURT OF THE UNITED STATES

IKE SLODOV,
Petitioner,
v.
UNITED STATES.

ORDER ALLOWING CERTIORARI. Filed October 3, 1977.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Sixth Circuit is granted. The case is set for oral argument in tandem with No. 76-1800.

Supreme Court, U. S.
FILED
AUG 15 1977
MICHAEL RODAK, JR., CLERK

No. 76-1835

In the Supreme Court of the United States

OCTOBER TERM, 1977

IKE SLODOV, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 76-1835

IKE SLODOV, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions of the bankruptcy judge (Pet. App. A22-A42) and the district court (Pet. App. A13-A20) are not officially reported. The opinion of the court of appeals (Pet. App. A1-A12) is reported at 552 F. 2d 159.

JURISDICTION

The judgment of the court of appeals was entered on April 5, 1977. The petition for a writ of certiorari was filed on June 23, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether petitioner is personally liable for the unpaid withholding tax liabilities of three of his corporations, pursuant to Section 6672 of the Internal Revenue Code of 1954.

STATUTES INVOLVED

The pertinent provisions of Sections 6672 and 7501 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at pp. 3-4 of the petition.

STATEMENT

On January 31, 1969, petitioner purchased the stock of three corporations, Tas-Tee Catering, Tas-Tee Vending and the Charles Corporation. Petitioner was in control of these corporations from January 31, 1969, through July 15, 1969, except for the two-week period from May 23, 1969, through June 4, 1969 (Pet. App. A2).

During the purchase negotiations, it was represented to petitioner that Tas-Tee had sufficient funds to pay all of its taxes and creditors. On February 1, 1969, petitioner sent to the Internal Revenue Service the corporations' Federal Insurance Contributions Act and withholding tax returns for the last quarter of 1968 and Tas-Tee Catering's returns for the second quarter of 1968. These returns were accompanied by checks totaling $262,705 for payment of the liabilities (Pet. App. A2; Govt. Ex. 6). On February 3, 1969, petitioner discovered that there were not sufficient funds available to cover the checks and he immediately stopped payment on them (Pet. App. A2).

Deposits were made into the corporate checking accounts during the week of February 3, 1969, so that from February 6, 1969, throught February 9, 1969, the balance in the accounts ranged between $130,000 and $150,000 (Joint Ex. 3). While under petitioner's control, the corporations continued to have current operating receipts totaling or exceeding $100,000 per week. Petitioner used these funds in part to pay some of the outstanding employment taxes due the government. However, it is undisputed that petitioner used the remaining part of

the funds to pay employees, rent, utilities and other creditors. Petitioner also reimbursed himself for several advances he had made to the corporations (R. 20, 57; Tr. 179, 181, 239, 348-349, 403-407).[1]

Subsequently petitioner entered into a proceeding for a Real Property Arrangement under Chapter XII of the Bankruptcy Act. The Internal Revenue Service filed a claim for $313,295 owed under assessments made pursuant to Section 6672 of the Internal Revenue Code of 1954 for the second and fourth quarters of 1968 and the first through third quarters of 1969. The bankruptcy judge found that petitioner was not responsible for the collection of withholding taxes until February 1, 1969 (Pet. App. A34). While he further found that petitioner was the person responsible for the collection of such taxes from February 1 to July 15, 1969, he concluded that petitioner's failure to withhold and pay over taxes was not willful within the meaning of Section 6672. He therefore concluded that petitioner was not liable for any of his corporations' unpaid withholding tax liabilities (Pet. App. A37).

The district court reversed the bankruptcy court in part. It ruled that petitioner was personally liable under Section 6672 for the unpaid withholding taxes only for the period after February 1, 1969 (Pet. App. A17-A19).

The court of appeals reversed. It held that petitioner was liable for the unpaid withholding taxes for the period prior to January 31, 1969, but not for the period after that date. It rejected petitioner's argument that he could not be the person responsible for the collection of such taxes prior to the time that he took over control of the corporations because there were no unencumbered corporate funds on hand at that time. As the court of appeals stated, "When the corporation came into possession of funds after * * * [petitioner] acquired control, these funds were impressed with a trust to the extent of the corporation's obligations for previously unpaid withholding income taxes and employees' share of social security taxes. Though created before * * * [petitioner's] control of the corporation began, these obligations continued after that date, and he was clearly the person responsible for paying them when funds became available" (Pet. App. A11).

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[1] "R." and "Tr." respectively refer to the record appendix filed in the court of appeals and the trial transcript.

ARGUMENT

1. Sections 3102(a) and 3402(a) and (d) of the Internal Revenue Code of 1954, as amended, require every employer to withhold federal income and social security taxes from the wages of his employees. Section 7501 provides that the withheld taxes constitute a special trust fund in favor of the United States. See *Newsome* v. *United States*, 431 F. 2d 742 (C.A. 5). If an employer withholds a tax but fails to pay it over to the United States, the employee is nevertheless credited with having paid the tax and the government will not require any additional payment from the employee. Thus, unless the government has recourse against the person responsible for the collection of the tax, the revenues would be put in jeopardy. *Dillard* v. *Patterson*, 326 F. 2d 302 (C.A. 5).

Section 6672 of the Code gives the government the necessary recourse against the responsible collection officers. It provides that "Any person required to collect * * * and pay over any tax * * * who willfully fails to * * * pay over such tax, * * * shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over." The thrust of the statute is to impose personal liability upon those persons whose conduct resulted in the failure to pay withheld taxes. *E.g.*, *Mueller* v. *Nixon*, 470 F. 2d 1348 (C.A. 6); *Spivak* v. *United States*, 370 F. 2d 612 (C.A. 2). In the typical case, as here, the statute is used as a collection device against officers of a bankrupt corporation for the taxes withheld from its employees' wages. See, *e.g.*, *Monday* v. *United States*, 421 F. 2d 1210, 1214-1215 (C.A. 7), certiorari denied, 400 U.S. 821; *Gefen* v. *United States*, 400 F. 2d 476, 482 (C.A. 5), certiorari denied, 393 U.S. 1119; *Hewitt* v. *United States*, 377 F. 2d 921, 924 (C.A. 5); *Burack* v. *United States*, 461 F. 2d 1282, 1285 (Ct. Cl.).

The court of appeals correctly held that petitioner was personally liable under Section 6672 for the unpaid taxes withheld prior to his assumption of control of the corporations. As the court stated (Pet. App. A11), "We conclude that it is irrelevant whether there were unencumbered funds on hand at the time * * * [petitioner] took control of Tas-Tee Catering. Prior to that time the employees of the corporation had received net wages which reflected withholding for income taxes and social security taxes." When petitioner took over the corporation which thereafter came into possession of funds, these funds were impressed with a trust to the extent of the corporation's unpaid withholding tax liabilities. Since petitioner was aware of the unpaid taxes and possessed the power and responsibility to pay them, his preference of other corporate creditors over the government rendered him liable for the tax under Section 6672. See *Braden* v. *United States*, 442 F. 2d 342, 344 (C.A. 6), certiorari denied *sub nom. Bonistall* v. *Braden*, 404 U.S. 912; *Teel* v. *United States*, 529 F. 2d 903 (C.A. 9). Accord: *Stake* v. *United States*, 347 F. Supp. 823 (D. Minn.); *Louisville Credit Men's Assn, Inc.* v. *United States*, decided September 29, 1970, 73-2 U.S.T.C. par. 9740 (E.D. Ky.).

2. Contrary to petitioner's argument (Pet. 7), the decision below does not conflict with *McCullough* v. *United States*, 462 F. 2d 588 (C.A. 5). There, the court rejected the government's imposition of Section 6672 liability upon a corporate officer who assumed his position after the taxes in question had been withheld and continued to serve in that capacity during a period in which certain funds came into the corporation's possession that would have been sufficient to discharge unpaid withholding taxes for prior periods. But as the court below correctly recognized (Pet. App. A9), *McCullough* turned on the fact "that it was clear from the evidence that the continued operation for approximately six months of the tenure of R. F. McCullough was at the will of a large factoring company which had security instruments covering substantially all the assets of the corporation and advanced funds for the operation only as itemized by specific voucher" (462 F. 2d at 590).

Unlike this case, the officer in *McCullough* had no unencumbered funds available to pay the withheld taxes. The Fifth Circuit specifically left open the question resolved against the officer in this case, *viz.*, the liability of a person who becomes an officer responsible for the payment of previously withheld unpaid withholding taxes when the corporation subsequently comes into possession of funds from which the officer could pay such taxes but fails to do so and instead disburses the funds for other purposes (*id.* at 590). *McCullough* held "only that the government did not prove facts sufficient to establish the existence of such a [trust] fund at a time when R. F. McCullough was the managing official" (*ibid.*). Here, in marked contrast, the court of appeals stated that "The evidence is undisputed that Tas-Tee Catering had in its possession during the period of

* * * [petitioner's] control large sums of money which it used to pay debts and operating expenses" (Pet. App. A9).[2]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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August 1977.

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[2] Petitioner also argues (Pet. 8) that the Fifth Circuit in *McCullough* stated that Section 6672 "is to be read in the conjunctive, whereas the Sixth Circuit has said the opposite." In petitioner's view, the statutory language—"person required to collect, truthfully account for, and pay over"—means that personal liability for withholding taxes can only be imposed on an officer who fails to perform each of the three enumerated functions, *viz.*, collection, accounting and payment. While we submit that Section 6672 is more properly read to reach an officer who fails to perform *any* one of the three functions, it was not necessary for the court below to address the correctness of the Fifth Circuit's dictum in *McCullough* because the decision in that case turned on the state of the evidence. At all events, the Fifth Circuit will shortly hear argument in *Brown* v. *United States* v. *Stifley* (No. 76-2381), which presents the question whether Section 6672 is applicable to a situation that is comparable to this case.

*The Solicitor General is disqualified in this case.

Supreme Court, U. S.
FILED
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Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari
To the United States Court of Appeals
For the Sixth Circuit

REPLY BRIEF OF PETITIONER

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Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

REPLY BRIEF OF PETITIONER

Respondent, at pages 2 and 3 of its Brief, states as follows:

> "Deposits were made into the corporate checking accounts during the week of February 3, 1969, so that from February 6, 1969, through February 9, 1969, the balance in the accounts ranged between $130,000 and $150,000 (Joint Ex. 3). While under petitioner's control, the corporations continued to have current operating receipts totaling or exceeding $100,000 per week. Petitioner used these funds in part to pay some of the outstanding employment taxes due the government. However, it is undisputed that petitioner used the remaining part of the funds to pay employees, rent, utilities and other creditors. Petitioner also reimbursed himself for several advances he had made to the corporations (R. 20, 57; Tr. 179, 181, 239, 348-349, 403-407)."

It should be noted that the expenditures to which Respondent refers were, in most part, if not entirely, in satisfaction of obligations for then current operating expenses. Many creditors insisted on a C. O. D. policy (A. 42). In fact, the amounts Respondent admits were used in part to pay the Government for employment taxes were on account of then current withholding obligations.

The absurdity of Respondent's position is illustrated by the extreme: If, at the time Petitioner became a responsible officer of the corporation, the unpaid trust fund liability equalled Two Hundred Fifty Thousand Dollars ($250,000.00) (there then being no funds of any amount available) the corporation would be required to pay its first Two Hundred Fifty Thousand ($250,000.00) in gross receipts to the Government lest a responsible officer violate Sections 7501 and 6672. Thus, the corporation could not even pay the employee charged with the responsibility for writing a check to the Government for such unpaid liability without running afoul of Sections 7501 and 6672. Seemingly, under Respondent's theory, the corporation also exposed Petitioner to liability under Sections 7501 and 6672 when it used current receipts to pay current employment taxes due the Government, rather than discharging the obligations for prior withholding liability.

A writ of certiorari should issue to review the judgment and opinion of the Sixth Circuit.

Respectfully submitted,

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Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
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UNITED STATES OF AMERICA,
Respondent.

BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the Court of Appeals for the Sixth Circuit is reported at 552 F.2d 159, 77-1 USTC Par. 9328 (6th Cir., 1977). The opinions of the District Court are unofficially reported and are found at 74-2 USTC Par. 9719 (N.D. Ohio, 1974); and 75-2 USTC Par. 9829 (N.D. Ohio, 1975), respectively. A copy of each of the opinions below has been included in the Appendix for the Court's convenient reference.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was filed on April 5, 1977, and within ninety (90) days of that date, on June 23, 1977, a petition for a writ of certiorari was filed. On October 3, 1977, this Court granted Petitioner's request for a writ of certiorari. This Court has jurisdiction under 28 U.S.C.A. Sec. 1254(1).

STATUTORY PROVISIONS INVOLVED

United States Code Annotated, Title 26:

Sec. 6671. Rules for application of assessable penalties.

"(b) Person Defined.—The term 'person', as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

Sec. 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax.

"Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable."

Sec. 7202. Willful failure to collect or pay over tax.

"Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution."

Sec. 7343. Definition of term "person".

"The term 'person' as used in this chapter includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

Sec. 7501. Liability for taxes withheld or collected.

"(a) General rule.—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

"(b) Penalties.—For penalties applicable to violations of this section, see sections 6672 and 7202."

Sec. 7701. Definitions.

"(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

"(1) Person.—The term 'person' shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation."

QUESTIONS PRESENTED

1. Whether personal liability under 26 U.S.C.A. Sec. 6672 (Internal Revenue Code Section 6672) may result to a person who was not a responsible party at the time withholding and collection of trust fund taxes were effectuated, but is a responsible party at some later time when funds acquired thereafter become available in sufficient amount to pay such taxes?

2. Whether a trust on later acquired funds arises in favor of the United States under 26 U.S.C.A. Sec. 7501 (Internal Revenue Code Section 7501) or any other legal authority for unpaid trust fund taxes for prior periods?

3. Does a responsible party become personally liable by not paying such outstanding liabilities out of later-acquired funds when, at the time he became a responsible party, there were no funds then available to pay any part of such outstanding trust fund taxes or any other liability?

STATEMENT OF THE CASE

Petitioner purchased all of the shares of Tas-Tee Corporation (the "Corporation") on January 31, 1969, and on the same day assumed control and command of the Corporation. At the time Petitioner assumed control there were unpaid trust fund taxes owing to the United States for various quarters ending in 1968 totaling about $177,000.00. In fact, however, when Petitioner took charge

of the Corporation, there were then no funds available to pay any part of the unpaid taxes or other debts. In fact, there was a bank overdraft (A. 33). Such taxes have not been paid.

Operating funds generated by the business of the Corporation after January 31, 1969, were used to pay current taxes and other operating expenses. On or about June 4, 1969, Slodov withdrew from the Corporation's direction. Thereafter, Slodov entered into a proceeding for a Real Property Arrangement under Chapter XII of the Bankruptcy Act.

In the course of the Bankruptcy proceedings, Internal Revenue Service filed various claims against Petitioner as a responsible officer of the Corporation for unpaid trust fund taxes for the period prior to January 31, 1969. The Bankruptcy Judge who heard this controversy held that Petitioner was not a responsible officer of the Corporation prior to January 31, 1969, since he was not responsible for the withholding, accounting for and payment of such taxes. He could, therefore, not be held liable under Internal Revenue Code Section 6672 for unpaid trust fund taxes arising prior to that date.

On appeal, the District Court upheld the Bankruptcy Judge's finding that Petitioner was not a responsible person for unpaid taxes arising prior to January 31, 1969.

The Court of Appeals for the Sixth Circuit, in turn, reversed the District Court's decision. It held that Petitioner was a responsible officer against whom a penalty could be assessed for unpaid taxes arising prior to January 31, 1969. The Court of Appeals remanded the case to the District Court for a determination of the exact amount of liability arising as a result of its decision.

ARGUMENT

Sections 3102(a) and 3402(a) and (d) of the Internal Revenue Code of 1954, as amended (Title 26, United States Code Annotated), impose an obligation upon every employer to withhold federal income and social security taxes from the wages of its employees. Section 7501(a) provides that the amount of taxes so withheld, shall constitute a special trust fund in favor of the United States:

> "Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States."

The term "any person" as used in Section 7501 means the employer, whether the employer be an individual, a trust, estate, partnership, association, company or corporation. See Section 7701(a)(1).

In the event an employer violates its statutory obligations under Section 7501(a), Section 7501(b) refers to Sections 7202 and 6672 for the imposition of penalties. Section 7202 imposes a *criminal* penalty on those persons (separately defined in Section 7343), who may have caused the violation. Section 6672 imposes a *civil* penalty on those persons (separately defined in Section 6671(b)), who are responsible for the violation. Both definitions of "person" are identical in wording.

Section 6672 was enacted to provide the United States with an alternate means of recourse of collecting certain taxes by imposing a one-hundred percent (100%) penalty on those persons, other than the employer, responsible for withholding, collecting and paying over such trust fund taxes on behalf of the employer. In this connection, Section 6672, providing for the above described penalty, in part, says:

> "Any person required to collect, truthfully account for, and pay over such tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

Congress, in enacting Section 6672, was apparently interested in protecting the revenue and intended that the taxes constituting the trust fund be fully collected from those responsible persons who may have caused any diversion thereof. The category of "persons" Congress intended to hold responsible are plainly defined in Section 6671(b) to include "an officer or employee of a corporation . . . who as such officer, employee . . . is under a duty to perform the act in respect of which the violation occurs." Thus, the combined impact of Sections 6672 and 6671(b) may be paraphrased as follows: Any officer or employee of a corporate employer who is under a required duty to collect, truthfully account for, and pay over any tax, who willfully fails to collect such tax, or truthfully account for and pay over such tax shall be liable to a penalty equal to the amount of the tax not collected, or not accounted for and paid over.

In the instant case, the United States seeks to cause the Petitioner to pay the amounts owed by the corporate employer for its violations of Section 7501. The alleged violations for which the one-hundred percent (100%) penalty is sought relates to so-called trust fund taxes arising in periods prior to February 1, 1969.

The relevant facts of this case are not disputed and are clearly stated in the record.

The first question which must be answered is whether Petitioner is a person described in Section 6671(b) who can be held personally liable under Section 6672 for the corporate employer's violation of Section 7501. Petitioner respectfully submits that the answer to this question is no.

The imposing language of Section 6672 is unmistakable. It reads: "Any person required to collect, truthfully account for, *and* pay over . . ." [emphasis ours]. Clearly, this Petitioner was under no duty to collect and account for the taxes in question. His association with the corporate employer did not commence until some time long after collection of the taxes were due and, in fact, withheld. Thus, to subject Petitioner to personal liability under Section 6672, this Court would have to read the clear and precise wording of that Section so that its imposing requirements read in the disjunctive rather than in the conjunctive. This is precisely the argument of the United States. The United States, here, does not argue that the Petitioner was a "person required to collect, truthfully account for, and pay over" trust fund taxes relating to liabilities arising prior to February 1, 1969. Rather, it argues that even though Petitioner was a person required only to "pay over" such moneys, he became personally liable therefor when he became a "responsible officer" of the corporate employer at some subsequent time when the employer *acquired* funds out of which pre-February 1, 1969 trust fund taxes could have been paid. Other courts have consistently refused to rewrite Section 6672 in this manner. In *McCullough v. United States,* 462 F.2d 588, 72-2 USTC Par. 9558 (5th Cir., 1972) the court addressed itself to this issue and rejected the argument of the United States. The court, in part, said:

> "The government here contends for a position which would, in effect, change the language of Section 6672 from 'person required to collect, truthfully account for, and pay over' to 'person required to collect, truthfully account for, [or] pay over.'
>
> * * * * *
>
> "The principal difficulty with this argument is that this is not the way the statute is written and there is no statutory authorization for the collection of this penalty. . ."

In order to counter the argument that the imposing requirements of Section 6672 must be read in the conjunctive and not in the disjunctive, the United States sometimes cites the cases of *Teel v. United States,* 529 F.2d 903; 76-1 USTC Par. 9190 (9th Cir., Jan. 5, 1976) and *Tiffany v. United States,* 228 F. Supp. 700, 64-2 USTC Par. 9501 (N.J., 1963), in which the courts held that a taxpayer who was a responsible officer during the collection procedure, but who was removed from that status prior to the date on which the amounts *were required to be paid over,* could be held liable under Section 6672. The United States has misread these cases. All three elements required to charge the taxpayer with the penalty—the requirements of collection, reporting and paying—all did in fact converge. While the taxpayer was removed as a responsible officer before the time payment was required *to be made,* he nevertheless came under the *requirement* of making the payment when he collected the taxes.

See *Tiffany, supra,* which states:

> "In re Serignese, D. C., 214 F. Supp. 917, supports the view that payment to employees made plaintiff inchoately or contingently liable for the penalty before adjudication, since the *liability for paying withheld*

> *taxes does not accrue on the date for paying them.*" [emphasis ours].

See also *Teel, supra*:

> "Appellants also make the more limited argument that they cannot be charged with a willful failure to pay over the taxes accrued during the month of November because the time of payment did not arise until after the receiver was appointed. As the employer withholds taxes from the employees, a contingent liability is created. The liability merely becomes fixed on the date when the payments are due. Thus the liability for the tax withheld from November 1 through November 23 attached to the appellants at the time they withheld the tax."

The United States argues that any responsible officer of a corporation acquiring available funds to pay a delinquent withholding type tax obligation for a prior period is obligated to earmark and use those after-acquired funds for the payment thereof, whether or not he was a responsible officer at the time the taxes in question were withheld or at the time they should have been paid over, and that willful failure to do so renders him liable under Section 6672. The United States refers to this argument as its "trust fund theory," and the Sixth Circuit, in the proceedings below, has deferred to it:

> "When the corporation came into possession of funds after Dr. Slodov acquired control, these funds were impressed with a trust to the extent of the corporation's obligations for previously unpaid withholding income taxes and employees' share of social security taxes. Though created before Dr. Slodov's control of the corporation began, these obligations continued after that date, and he was clearly the person responsible for paying them when funds became available."

The difficulty with the so-called "trust fund theory" is that there is no statutory authority for it. The Sixth Circuit did not cite authority for its conclusion, and the court in *McCullough, supra*, although not directly resolving the issue, seems to reject the notion:

> ". . . we do not decide the liability of a person who becomes an officer responsible for the payment of withheld but not accounted for and not paid withholding and FICA taxes at a time when the corporation has funds from which the managing head of the corporation could discharge the defaulting corporation's trust obligation to the government and exercises his control to disburse such trust funds for other purposes."

* * * * *

> ". . . there is no statutory authorization for the collection of this penalty, *even though the taxpayer had free funds available for the purpose of paying the taxes.*" [emphasis ours].

Section 7501 does not sanction the creation of an impressed trust on after-acquired funds. Section 7501 is specific in its reach. It says that the special fund held in trust for the United States is only ". . . the amount of tax so collected or withheld. . . ." [emphasis ours]. Interestingly, not even the Internal Revenue Service recognized the validity of the United States' "trust fund theory." Its agent instructed Petitioner to use after-acquired funds entering the corporation's coffers to discharge then currently arising tax and other obligations before such funds were used to liquidate prior outstanding liabilities (A. 2-3; 15-17).

Assuming arguendo that an impressed trust is engrafted on subsequent funds under the thrust of Section 7501, there is no authority which imposes personal liability upon Petitioner. Section 7501 standing alone does not do it because its use of the term "person" refers only to the employer. And certainly Section 6672 does not reach Petitioner for the reasons already discussed. Finally, if Petitioner is to be viewed as a successor trustee to the "trust" created under Section 7501 and to which the "impressed funds" relate, he cannot be held personally liable to the United States for defalcations and other breaches of trust committed by his predecessor trustee. See RESTATEMENT OF TRUSTS, Sec. 223. This is so because at the time Petitioner assumed his status as successor trustee, there were no funds whatsoever constituting trust corpus out of which he could make good the defalcations.

There are responsible officers of the delinquent corporate employer against whom the United States may appropriately seek recourse for the alleged violations. However, this Petitioner is simply not that "person."

CONCLUSION

For these reasons, the judgment and opinion of the Sixth Circuit Court of Appeals herein appealed from should be reversed.

Respectfully submitted,

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Dated: November 14, 1977

FOR ARGUMENT

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In the Supreme Court of the United States

OCTOBER TERM, 1977

IKE SLODOV, PETITIONER
v.
UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinions of the bankruptcy judge (Pet. App. A22-A42) and the district court (Pet. App. A13-A20) are not officially reported. The opinion of the court of appeals (Pet. App. Al-A12) is reported at 552 F. 2d 159.

JURISDICTION

The judgment of the court of appeals was entered on April 5, 1977 (Pet. 2). The petition for a writ of certiorari was filed on June 23, 1977, and was granted on October 3, 1977 (A. 59). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Section 6672 of the Internal Revenue Code of 1954 makes personally liable for taxes "[a]ny person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof * * *."

The question presented is whether petitioner is personally liable under Section 6672 for unpaid taxes of three of his corporations withheld from employees' wages prior to petitioner's assumption of control of the corporations, where the corporations thereafter acquired funds sufficient to pay the taxes but petitioner willfully failed to pay them over to the government.

STATUTES INVOLVED

The pertinent provisions of Section 6671, 6672 and 7501 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth in the Appendix, *infra*, pp. 1A–2A.

STATEMENT

1. On January 31, 1969, petitioner purchased the stock of three corporations engaged in the food vending business, Tas-Tee Catering, Tas-Tee Vending and the Charles Corporation. Petitioner was in absolute control of these corporations and their disbursements from January 31, 1969 through July 15, 1969, except for the two-week period from May 23 through June 4, 1969 (Pet. App. A2; A4).

During the purchase negotiations, the sellers represented to petitioner that the corporations had sufficient funds to pay all of their existing tax obligations and other debts. On February 1, 1969, petitioner sent to the Internal Revenue Service the corporations' Federal Insurance Contributions (social security) and withholding tax returns for the last quarter of 1968 and Tas-Tee Catering's returns for the second quarter of 1968. These returns were accompanied by corporate checks for payment of the liabilities (Pet. App. A2). On February 3, 1969, petitioner discovered that the corporations did not have sufficient funds in their accounts to cover the checks and he immediately stopped payment on them (Pet. App. A2).

While under petitioner's control the corporations continued to have current operating receipts of approximately $130,000 per week (A. 14). Petitioner used these funds in part to pay a small portion of the outstanding employment taxes due the government (A. 13–14). However, the evidence is undisputed that during the period of petitioner's control, the corporations had large sums of money which they used to pay employees, rent, utilities and other creditors, to purchase supplies, and to meet the other day-to-day expenses (Pet. App. A9, A41–A42; A. 6–8, 14). Thus, for example, during the period of petitioner's control, the corporations paid $100,000 to discharge a loan they owed to Metropolis Industries (A. 9).

In July 1969, petitioner withdrew from the direction of the corporations' business. Subsequently, petitioner instituted a proceeding for a Real Property Arrangement under Chapter XII of the Bankruptcy Act. The Internal Revenue Service filed in the proceeding a claim for $313,740 owed under assessments made pursuant to Section 6672 of the Internal Revenue Code for the second and fourth quarters of 1968 and the first through the third quarters of 1969 (Pet. App. A36).

The bankruptcy judge found that petitioner was not responsible for withholding taxes collected prior to February 1, 1969 (Pet. App. A34). While he further found that petitioner was the person responsible for the collection of such taxes from February 1 to July 15, 1969, he concluded that petitioner's failure to withhold and pay over taxes was not willful within the meaning of Section 6672. He therefore concluded that petitioner was not personally liable for any of his corporations' unpaid withholding tax liabilities (Pet. App. A37).

The district court affirmed the bankruptcy judge insofar as he held that petitioner was not liable for the withholding taxes for periods prior to February 1, 1969, but ruled that petitioner was liable for the unpaid withholding taxes after that date (Pet. App. A17–A19).

2. The court of appeals reversed both rulings. It concluded that petitioner was required to account for and pay over taxes collected prior to February 1, 1969.

Since petitioner was aware of the unpaid taxes and possessed the power and responsibility to pay them, his subsequent use of corporate funds to prefer other creditors over the government rendered him liable for the taxes under Section 6672 for the period prior to January 31, 1969[1] (Pet. App. A1–A12).

The court of appeals recognized that the amount of withheld taxes constitutes a special trust in favor of the United States. See 26 U.S.C. 7501. It rejected petitioner's argument that he was not liable for unpaid withholding taxes for periods prior to the time that he assumed control over the corporations because there were no unencumbered corporate funds on hand at that time. The court stated: "When the corporation came into possession of funds after * * * [petitioner] acquired control, these funds were impressed with a trust to the extent of the corporation's obligations for previously unpaid withholding income taxes and employees' share of social security taxes. Though created before * * * [petitioner's] control of the corporation began, these obligations continued after that date, and he was clearly the person responsible for paying them when funds became available" (Pet. App. A11).

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[1] The court of appeals' decision that petitioner was not liable for withholding taxes for the period February 1 through July 15, 1969 rested upon an agreement between the corporations and the Internal Revenue Service to apply any payments to current liabilities (see Pet. App. A4–A7). Since the question upon which certiorari has been granted involves petitioner's liability only for the period prior to February 1, 1969, the portion of the court of appeals' opinion captioned "SLODOV'S APPEAL" (Pet. App. A4–A7) has no bearing upon the issue before the Court.

SUMMARY OF ARGUMENT

A.

Sections 3102(a) and 3402(a) and (d) of the Internal Revenue Code of 1954, as amended, require every employer to withhold federal income and social security taxes from the wages of his employees. Section 7501 provides that the withheld taxes constitute a special trust fund in favor of the United States. If an employer withholds a tax but fails to pay it over to the United States, the employee is nevertheless credited with having paid the tax and the government will not require any additional payment from the employee. Thus, unless the government has recourse against the person responsible for the collection and payment of the tax, the revenues would be put in jeopardy.

Section 6672 of the Code gives the government recourse against the responsible person. It imposes personal liability upon "[a]ny person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax * * *." The thrust of the statute is to impose personal liability upon those persons whose conduct results in the failure to pay withheld taxes. In the typical case, as here, the statute is used as a collection

device against officers of a bankrupt corporation for the taxes withheld from its employees' wages.

The court of appeals correctly held that petitioner was personally liable under Section 6672 for the unpaid taxes withheld prior to his assumption of control of the corporations. When petitioner took over the corporations which thereafter came into possession of funds, he was required to use those funds to discharge the corporations' unpaid withholding tax liabilities. Since petitioner was aware of the unpaid taxes and possessed the power and responsibility to pay them, his preference of other corporate creditors over the government rendered him liable for the tax under Section 6672.

B.

1. The language of the statute fully supports the imposition of personal liability against petitioner. After January 31, 1969, when petitioner was in control of the corporations, he was a "person required to collect, truthfully account for, and pay over" the taxes of the corporations. When he thereafter failed to pay over to the government the taxes his corporations previously had withheld from their employees, he became liable for those taxes under Section 6672 because, as a person that the statute covered, he failed to comply with one of its obligations, *i.e.,* that he "truthfully account for and pay over such tax[es]."

Petitioner argues that the Section 6672 liability for unpaid withholding taxes does not attach with respect to taxes withheld from employees' wages prior to his assumption of control of the corporations. He relies upon the statutory language—"person required to collect, truthfully account for, *and* pay over any tax" (emphasis supplied)—and argues that he was not required to perform all three of these functions with respect to the tax dollars withheld prior to his assumption of control of the corporations.

But petitioner's reading of Section 6672 is not only inconsistent with the basic policy of the statute but is incorrect. The statute does not condition personal liability upon the responsible officer's performance of three enumerated functions with respect to specific tax dollars during a particular quarter. To the contrary, the statute simply identifies for potential liability the person who, at a given point in time, is required to perform all three functions of collection, accounting, and payment, and who willfully fails to discharge any one of those functions. Since petitioner was a "person required to collect, truthfully account for, and pay over any tax" and willfully failed to "pay over such tax[es]," he is personally liable under Section 6672.

2. Petitioner's reading of the statute would undermine the "basic purpose [of Section 6672 which] is the protection of governmental revenue * * *." *Monday* v. *United States*, 421 F. 2d 1210, 1216 (C.A. 7), certiorari denied, 400 U.S. 821. If petitioner were correct, a successor officer, whose conduct results in the non-payment of withholding taxes, could disclaim responsibility for such taxes on the ground that he was not in control at the time they were withheld, and neither the predecessor nor the successor officer would be liable under Section 6672. Given the statutory purpose of preventing the unnecessary loss of tax revenues, there is no justification for the result petitioner urges. Indeed, to conclude otherwise would enable a successor officer deliberately to ignore the corporation's past withholding tax obligations without fear of the sanction of personal liability.

Here, the evidence is undisputed that during the period of petitioner's control the corporations came into possession of large sums of money which it used to pay debts and expenses. Hence, the facts of this case fully support the application of the rule that we urge with respect to Section 6672, *i.e.*, that a person who assumes control of a corporation, knows of its unpaid withholding taxes, and thereafter uses funds that came into the corporation's possession to prefer other creditors over the United States, is personally liable for the unpaid taxes.

ARGUMENT

SECTION 6672 OF THE INTERNAL REVENUE CODE IMPOSES PERSONAL LIABILITY UPON AN OFFICER OF A CORPORATION FOR UNPAID TAXES WITHHELD FROM EMPLOYEES' WAGES PRIOR TO HIS ASSUMPTION OF CONTROL OF THE CORPORATION, WHERE THE CORPORATION THEREAFTER ACQUIRES FUNDS SUFFICIENT TO PAY THE TAXES BUT THE OFFICER WILLFULLY FAILS TO PAY THEM

A. INTRODUCTION

This federal tax case presents a question concerning the scope of the personal liability for unpaid withholding taxes imposed by Sections 6671(b) and 6672 of the Internal Revenue Code upon persons required to collect and pay over such taxes. As we have stated in greater detail in our brief in *United States* v. *Sotelo* (No. 76–1800),[2] the collection of income taxes by withholding at the source has been an integral part of the internal revenue laws since 1942. Sections 3102(a) and 3402(a) and (d) of the 1954 Code require every employer to withhold federal income and social security taxes from the wages of his employees. The importance of this method of collection is shown by the fact that withholding taxes on wages recently accounted for 83 percent of the total amount of individual income tax collections.[3]

In imposing the collection obligation and the liability for withheld taxes upon the employer, Congress recognized that employers might fail to set aside and pay over these taxes to the government. If a corporation proved unable to pay the taxes and went out of existence in a liquidating bankruptcy, the Treasury would suffer the loss because the employees from whose wages the taxes were withheld would still be credited with those amounts against their tax liability as if they had

been in fact paid to the government. *Dillard* v. *Patterson,* 326 F. 2d 302, 304 (C.A. 5); *Moore* v. *United States,* 465 F. 2d 514, 517–518 (C.A. 5), certiorari denied, 409 U.S. 1108; *Hartman* v. *United States,* 538 F. 2d 1336, 1340 (C.A. 8). Since the government credits the employees' accounts with the taxes withheld it necessarily obligates itself to pay social security benefits and income tax refunds to the employees even though it has not received the necessary taxes. Thus, when withholding taxes are not paid, the government potentially stands to suffer a twofold loss—first, by failing to receive taxes that are lawfully due, and second, by disbursing benefits on the assumption that the taxes necessary to fund those benefits have been paid.

Congress sought to protect against such losses by requiring that withheld taxes "shall be held to be a special fund in trust for the United States" (Section 7501, Appendix, *infra,* p. 2A) and imposing personal liability for those taxes upon those whose control of the financial affairs of a business entity requires them to collect and pay over taxes collected from third parties. Section 6672 of the Code gives the government recourse against those responsible for collection who breach their fiduciary obligation to maintain a special trust fund for the benefit of the United States. It provides that "[a]ny person required to collect, truthfully account for, and pay over any tax * * * who willfully fails to collect such tax, or truthfully account for and pay over such tax * * *" shall be personally liable for the amount of the tax not collected and paid over. Section 6671(b) defines the statutory term "person" to include "an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs."

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[2] The question presented in *Sotelo,* which is set for oral argument in tandem with this case, is whether the liability imposed by Section 6672 is dischargeable in bankruptcy. While this case also arose in the context of a proceeding under Chapter XII of the Bankruptcy Act, petitioner does not contend that his liability under Section 6672 is dischargeable in bankruptcy. We are serving a copy of this brief upon counsel for the respondent in *Sotelo.*

[3] *Annual Report of the Commissioner of Internal Revenue,* p. 137 (1976).

The thrust of Section 6672 is to impose personal liability upon those persons whose conduct resulted in the failure to pay withholding tax obligations. See, *e.g., Mueller* v. *Nixon,* 470 F. 2d 1348 (C.A. 6), certiorari denied, 412 U.S. 949; *Spivak* v. *United States,* 370 F. 2d 612 (C.A. 2), certiorari denied, 387 U.S. 908. In the typical case, as here, the statute is used as a collection device against officers of a bankrupt corporation for the taxes withheld from its employees' wages. The appellate courts have recognized that "the Congress in enacting § 6672 was solely interested in protection of the revenue and intended that the trust funds be fully collectible from those responsible persons who caused the diversion * * *." *Spivak* v. *United States, supra,* 370 F. 2d at 616. Accord: *Monday* v. *United States,* 421 F. 2d 1210, 1216 (C.A. 7), certiorari denied, 400 U.S. 821; *Harrington* v. *United States,* 504 F. 2d 1306, 1311 (C.A. 1); *Cross* v. *United States,* 311 F. 2d 90, 94 (C.A. 4); *Moore* v. *United States, supra,* 465 F. 2d at 517; *Mueller* v. *Nixon, supra,* 470 F. 2d at 1350; *Sorenson* v. *United States,* 521 F. 2d 325, 328 (C.A. 9); *White* v. *United States,* 372 F. 2d 513, 516 (Ct. Cl.).

Two requirements must be met for liability under Section 6672 to attach to a particular person. First, the party assessed must be a person required to collect, truthfully account for, and pay over the tax. Second, his failure to collect or to account for and to pay over the tax must be willful. *Hartman* v. *United States,* 538 F. 2d 1336, 1340 (C.A. 8). The test whether a particular official of a business is a responsible person is whether he had control of the disbursements of the taxpayer, *i.e.,* whether "he had the final word as to what bills should or should not be paid, and when." *Wilson* v. *United States,* 250 F. 2d 312, 316 (C.A. 9). See also *Hartman* v. *United States, supra,* 538 F. 2d at 1340; *Haffa* v. *United States,* 516 F. 2d 931, 935–936 (C.A. 7).

"Willfulness" under the statute does not connote fraudulent intent or evil motive. It is sufficient if the failure to pay the withholding tax obligations was the result of conscious acts or omissions by the responsible person with knowledge of the existence of the corporation's obligations to make such payments. See *Monday* v. *United States, supra,* 421 F. 2d at 1216, and cases cited therein. Thus, if the responsible person uses corporate funds to pay creditors other than the United States and knows that such disbursements will reduce the corporation's cash below the level of the withholding tax liabilities owed to the government, he is personally liable for the taxes under Section 6672 if the corporation is unable to pay them. *Newsome* v. *United States,* 431 F. 2d 742, 748 (C.A. 5).

B. THE LANGUAGE AND PURPOSE OF SECTION 6672 DEMONSTRATE THAT IT IMPOSES PERSONAL LIABILITY UPON A CORPORATE OFFICER WHO WILLFULLY FAILS TO USE CORPORATE ASSETS TO PAY OUTSTANDING WITHHOLDING TAX OBLIGATIONS OF THE CORPORATION

Petitioner does not dispute the foregoing principles. Nor does he challenge the facts that he was a "person required to collect, truthfully account for, and pay over any tax" after February 1, 1969, and that he thereafter disbursed funds of his corporations to creditors other than the United States despite his knowledge that there were outstanding withholding tax liabilities due to the government. However, he argues that the Section 6672 liability for unpaid withholding taxes does not attach with respect to taxes withheld from employees' wages prior to his assumption of control of the corporations.

Petitioner relies upon the statutory language—"person required to collect, truthfully account for, *and* pay over any tax" (emphasis supplied)—and argues that he was not required to perform all three of these functions with respect to the tax dollars withheld prior to his assumption of control of the corporations. According to petitioner, the imposition of liability in such a case would do violence to the terms of the statute by reading the first clause with the disjunctive "or" instead of the conjunctive "and."

Petitioner's reading of Section 6672 is not only inconsistent with the basic policy of the statute (see pp. 16–18, *infra*) but is incorrect.

1. After January 31, 1969, when petitioner was in control of the corporations, he was a "person required to collect, truthfully account for, and pay over" the withholding taxes of the corporations. When he thereafter failed to use monies that came into the possession of the corporations to pay over such taxes to the government, he became personally liable under Section 6672 because, as a person the statute covered, he failed to comply with one of its obligations, *i.e.*, that he "truthfully account for and pay over such tax[es]." The words "such tax" do not refer to the actual tax dollars that the responsible officer collected, but to "any tax imposed by this title," which includes the corporation's withholding tax obligations.

The obligation to truthfully account for and pay the tax is one unified act and the failure to perform either element of that act triggers personal liability. In the second clause of the statute, which lists the three obligations of a responsible officer, the conjunctive phrase "truthfully account for and pay over such tax" is framed by commas. By contrast, in the first clause of the statute, which defines a responsible officer in terms of his obligations, the three functions of collection, truthfully accounting for, and payment are each separated by commas. Petitioner's failure to pay the corporations' withholding taxes with funds that came into their possession was a failure "truthfully [to] account for and pay over such tax" within the meaning of the statute.

In sum, Section 6672 simply identifies for potential liability the person who, at a given point in time, is required to perform all three functions of collection, accounting, and payment, and who willfully fails to discharge any one of those functions so that taxes are not paid. The imposition of Section 6672 liability upon petitioner is compatible with a conjunctive reading of the first clause of the statute because he was a person "required to collect, truthfully account for, *and* pay over" his corporation's withholding taxes at the time he failed to pay them over.

2. The "basic purpose [of Section 6672] is the protection of governmental revenue. [Citations omitted.] It provides a remedy to prevent the unnecessary loss of tax funds by permitting the 'taxing authority to reach those responsible for the corporation's failure to pay the taxes which are owing.' " *Monday* v. *United States, supra,* 421 F. 2d at 1216, quoting from *United States* v. *Graham,* 309 F. 2d 210, 212 (C.A. 9).

Petitioner's reading of Section 6672 would frustrate the statutory purpose of protecting the revenue from the willful failure of responsible officers to pay over withholding taxes to the government. For example, suppose that responsible officer A withholds taxes from the corporation's employees during a particular quarter. A resigns his position at the end of the quarter and B succeeds to the control of the financial affairs of the corporation. Thereafter, B is required to pay over the withheld taxes to the government. Instead, however, he uses corporate funds to pay other creditors and fails to pay the corporation's tax liabilities.

On these facts, A was the person required to collect the taxes and B was the person required truthfully to account for and pay over the taxes to the government. Under petitioner's reading of the statute, however, neither A nor B would be personally liable for the taxes: A was only required to collect (*i.e.,* withhold) them and not account for and pay them over, and B was required only to account for and pay over the taxes. Under petitioner's theory, no one would be liable under Section 6672 because no corporate officer was required to perform all three functions with respect to the particular tax dollars withheld from the employees' wages.[4] As we have noted, the statutory language does not require such a bizarre result, which would enable a successor responsible officer deliberately to ignore the corporation's withholding tax liability without personal liability.[5]

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[4] The error of petitioner's position is underscored by his inconsistency with respect to the example of a predecessor responsible officer who transmits withheld taxes to his successor, who in turn willfully uses the fund to prefer other creditors. In his petition (p. 8), petitioner suggested that the successor officer would be liable under Section 6672 in such a case but not where the trust officer failed to transmit the withheld taxes to his successor. But petitioner's reading of the statute would necessarily exculpate any responsible officer from liability for taxes collected by a predecessor, whether or not the predecessor turns over funds sufficient to cover the accrued tax liability.

[5] Contrary to petitioner's suggestion (Reply Br. [at petition stage] 2), the government's argument does not subject a successor responsible officer to the onerous choice of paying the withholding taxes or having the corporation terminate its business. Petitioner's risk as a successor responsible officer is precisely the same as that of his predecessor. If either of them had funds available to pay withholding taxes and preferred other corporate creditors, he is personally liable under the statute. Petitioner erroneously assumes that an insolvent corporation with unpaid withholding taxes should be permitted to continue its business under the aegis of a successor officer even at the cost of the government's tax claim.

At all events, "[i]t is the duty of this Court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance, but if this leads to an unreasonable result plainly at variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment and inquire into its antecedent history and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail." *Ozawa* v. *United States*, 260 U.S. 178, 194. Accord: *Holy Trinity Church* v. *United States*, 143 U.S. 457; *Helvering* v. *New York Trust Co.*, 292 U.S. 455, 464. The purpose of Section 6672 to protect the revenue by imposing liability upon persons responsible for failing to satisfy a corporation's withholding tax liability requires that the section cover petitioner's willful preference of other corporate creditors over the United States.[6]

Section 6672, however, does not give a successor officer that option. Once he takes control of the corporation and continues its business for his own benefit while knowing of the outstanding tax obligations, he assumes the same position as his predecessor. Thus, if the corporation receives any funds and the responsible officer uses them to prefer other creditors over the United States, he is personally liable under Section 6672.

[6] Petitioner errs in arguing (Br. 11–12) that Section 7501 does not sanction the creation of an impressed trust on after-acquired funds because it only refers to "the amount of tax so collected or withheld * * *." The trust fund concept of Section 7501 is not limited to the actual dollars withheld from employees' wages but covers any corporate assets equal to the amount of accrued withholding tax liabilities. If, as here, a responsible officer knowingly fails to use available corporate assets to pay withholding taxes, he has breached the "special fund in trust for the United States

3. The foregoing analysis is generally supported by the decided cases. In *Anderson* v. *United States*, 561 F. 2d 162 (C.A. 8), the court rejected a contention identical to that of petitioner that the personal liability imposed by Section 6672 did not cover taxes withheld before the responsible person, a bonding company acting as surety for the corporation's performance of a particular contract, took over control of the corporation. Citing and quoting from the decision below with approval, the court stated: "The liability extends to payment of taxes withheld *before* the bonding company took charge" (561 F. 2d at 166; emphasis supplied). Since it was undisputed that the bonding company, like petitioner, knew about the unpaid taxes and subsequently received funds which it used to prefer the corporation's other creditors over the United States, the court held that the bonding company was a "responsible person" under Section 6671(b) and was therefore liable for the unpaid taxes under Section 6672. Accord: *Stake* v. *United States*, 347 F. Supp. 823, 826–827 (D. Minn.); *Astleford* v.

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* * *." At all events, Section 7501, which was intended to protect the government's collection of taxes, cannot be read to reduce the personal liability imposed by Section 6672.

Thus the principle of Section 223(1), A.L.I., *Restatement Second of Trusts* (1959 ed.) that a successor trustee cannot be held liable for the breaches of trust committed by his predecessor, upon which petitioner relies (Br. 12), is irrelevant. Petitioner's preference of other corporate creditors over the United States was itself a breach of trust independent of the breaches petitioner's predecessors committed. Indeed, the rule of the *Restatement* supports our submission, since Section 223(2) provides that "[a] trustee is liable to the beneficiary for breach of trust, if he (a) knows or should know of a situation constituting a breach of trust committed by his predecessor and he improperly permits it to continue * * *."

United States, 75–1 U.S.T.C., par. 9464, decided May 5, 1975 (D. Minn.); *Rubin* v. *United States,* 380 F. Supp. 1176, 1179 (W.D. Pa.), affirmed without opinion, 515 F. 2d 507 (C.A. 3); *Louisville Credit Men's Assn., Inc.* v. *United States,* 73–2 U.S.T.C., par. 9740, decided September 29, 1970 (E.D. Ky.).

The only arguable exception to this consistent line of authority is *McCullough* v. *United States,* 462 F. 2d 588 (C.A. 5), upon which petitioner relies (Br. 8–9, 11). There, the court rejected Section 6672 liability for a corporate officer who assumed his position after the taxes in question had been collected and withheld and continued to serve in that capacity during a period in which certain funds came into the corporation's possession that would have been sufficient to discharge unpaid withholding taxes for prior periods. The court suggested that the government's position "would in effect, change the language of Section 6672 from 'person required to collect, truthfully account for, and pay over' to 'person required to collect, truthfully account for, *or* pay over' " (462 F. 2d at 590). As we have argued *supra,* pp. 15–16, petitioner was a "person required to collect, truthfully account for, and pay over" within the meaning of Section 6672.

The court below correctly recognized that the observations of the Fifth Circuit in *McCullough* with respect to the conjunctive versus the disjunctive readings of the statute were dictum that did not govern the resolution of that case. As the court of appeals here concluded (Pet. App. A8–A9), *McCullough* turned on the fact "that it was clear from the evidence that the continued operation for approximately six months of the tenure of R. F. McCullough was at the will of a large factoring company which had security instruments covering substantially all the assets of the corporation and advanced funds for the operation only as itemized by specific voucher" (462 F. 2d at 590). Thus, the court in effect held that during the pertinent quarters McCullough did not have the authority to exercise the unfettered control of a responsible officer but was subject to the will of the factoring company. He was not a responsible officer.[7]

Moreover, the Fifth Circuit in *McCullough* specifically left open the question resolved against the officer in this case, *viz.,* "the liability of a person who becomes an officer responsible for the payment of withheld but not accounted for and not paid withholding and FICA taxes at a time when the corporation has funds from which the managing head of the corporation could discharge the defaulting corporation's trust obligation to the government and exercises his control to disburse such trust funds for other purposes" (462 F. 2d at 590). *McCullough* therefore does not reject our position in this case. It held "only that the government did not prove facts sufficient to establish the existence of such a fund at a time when R. F. McCullough was the managing official" (*ibid.*).

Here, in marked contrast, as the court of appeals stated, "[t]he evidence is undisputed that Tas-Tee

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[7] We do not mean to suggest that a responsible officer may avoid Section 6672 liability during his tenure by obtaining credit for the corporation from a third party on the condition that the creditor have the power to determine how corporate funds are disbursed. See *Kalb* v. *United States,* 505 F. 2d 506, 510 (C.A. 2), certiorari denied, 421 U.S. 979.

Catering had in its possession during the period of * * * [petitioner's] control large sums of money which it used to pay debts and operating expenses" (Pet. App. A9). The facts of this case fully support the application of the rule that we urge with respect to Section 6672, *i.e.*, that a person who assumes control of a corporation, knows of its unpaid withholding taxes, and thereafter uses funds that come into the corporation's possession to prefer other creditors over the United States, is personally liable for the unpaid taxes.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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January 1978.

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[*] The Solicitor General is disqualified in this case.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6671. RULES FOR APPLICATION OF ASSESSABLE PENALTIES.

(a) *Penalty Assessed as Tax.*—The penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary or his delegate, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter.

(b) *Person Defined.*—The term "person", as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

SEC. 6672. FAILURE TO COLLECT AND PAY OVER TAX, OR ATTEMPT TO EVADE OR DEFEAT TAX.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

* * * * *

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FOR ARGUMENT

Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari
To the United States Court of Appeals
For the Sixth Circuit

REPLY BRIEF OF PETITIONER

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ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

REPLY BRIEF OF PETITIONER

Contrary to Respondent's implications at page 14 and elsewhere of its Brief, Petitioner does dispute the interpretation and application of principles set forth by Respondent.

Respondent takes exception to Petitioner's reading of the language of Section 6672. That Section is clearly written. It first describes the person within its scope and next defines the actions by such person which give rise to its prescribed penalty:

> "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts

> in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

In order to bring Petitioner within the reach of Section 6672, Respondent argues that Petitioner need not be the person described in the Statute *at the time* the taxes in issue were required to be collected, truthfully accounted for, and paid over to the United States. According to Respondent's position, the Statute is satisfied if Petitioner was a person required to collect, truthfully account for, and pay over any tax, at *any* time, no matter when the tax liability arose. Respondent does not attempt to justify this reading of the Statute with any authority. Rather, it takes its interpretation of the Statute for granted and seeks to fix liability upon the Petitioner because, when he became a so-called "person" described in the Statute, he failed to "truthfully account for and pay over" certain taxes arising prior to the time he became a responsible officer. In order to justify this untenable interpretation of the Statute, Respondent looks to the words "such tax" contained in that part of the Statute defining acts giving rise to the prescribed penalty, and suggests that such words have the same meaning as "any tax imposed by this title" appearing earlier in the Statute. Thus, Respondent concludes that the language of Section 6672 does not refer to the tax or tax dollars for which the alleged violation relates, but refers instead to "any tax" arising at any time. Petitioner respectfully disagrees with Respondent's convoluted reading of Section 6672. The wording "any tax imposed by this title" appearing in the first part of the Statute describes the type of tax that can be the subject of the penalty and can logically be read only in conjunction with the wording preceding it, i.e. any tax imposed by this title which is required to be collected from others, truthfully accounted for, and paid over to the United States. If separately read, as Respondent argues, without the limitation herein contended for by Petitioner, "any tax imposed by this title" would, for example, include corporate income and other taxes clearly beyond the scope of Section 6672 and cast personal liability on responsible officers therefor. Thus, the words "such tax" means "any tax imposed by this title" required to be collected by the particular person with whom we are dealing. Obviously, Petitioner was not required to collect the taxes accruing prior to February 1, 1969.

Respondent also argues by means of a hypothetical example at pages 16 and 17 of its Brief, that Petitioner's reading of Section 6672 would frustrate the purpose of the Statute by allowing responsible persons otherwise subject to its provisions to escape its reach by timely shifts in responsibility. This is simply not a correct interpretation of Petitioner's position and Respondent's example fails to consider judicial replies to such situations.

There is no dispute that Section 6672 was enacted to provide the United States with an alternative means of recourse of collecting certain taxes by imposing a one hundred percent (100%) penalty on those persons who may have breached their fiduciary obligation to maintain a special trust fund for the benefit of the United States. Petitioner fully supports the purpose of Section 6672 and agrees that those persons responsible for violations of their fiduciary duties should not escape liability. Petitioner, however, did not violate any fiduciary responsibility and Respondent's claim that he did is without merit. The record of this case clearly demonstrates that if any diversion of "withheld" funds occurred, such actions were those of Petitioner's predecessors, and not Petitioner. Respondent's efforts to attach liability upon Petitioner for events preceding his involvement and beyond his control are unjustified. In *Louisville Credit Men's Ass'n, Inc. v. United States*, 73-2 U.S.T.C. ¶9740 (E.D. Ky., 1970), a case factually similar to the present one, the Court recognized the problem of strategic shifts in responsibility but refused to impose a Section 6672 penalty upon a person who was not responsible for the events giving rise to the alleged defalcation. The Court, in part, says:

> ". . . the statute would be emasculated beyond the ordinary meaning of its words if it were construed so as to allow those who would otherwise be within its purview to exempt themselves by stratigically [sic] timed shifts in responsibility, *it is equally apparent that the statute is not intended as a basis for imposition of penalties as a result of events substantially beyond the control of the one against whom such imposition is sought.*" [Emphasis ours.]

The cases of *Teel v. United States*, 76-1 U.S.T.C. ¶9190 (9th Cir., 1976) and *Tiffany v. United States*, 228 F. Supp. 700 (N.J., 1963) cited to this Court in Petitioner's original Brief, provide clear solutions to the problem of strategic shifts raised by Respondent in its hypothetical example.

Respectfully submitted,

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